Trade and Commerce Agency:

More Can Be Done To Measure the Return on the State's Investment and To Oversee Its Activities

April 1996
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CALIFORNIA STATE AUDITOR

April 24, 1996 95118

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee and through language in the Supplemental Report of the 1995-96 Budget Act, the Bureau of State Audits presents its audit report concerning the Trade and Commerce Agency (agency). Our review focused on whether the agency's planning efforts, management systems, and organizational structure for carrying out its mission were effective and efficient. This report concludes that more can be done by the agency to measure the return on the State's investment and to oversee its activities. Specifically, the agency needs to better measure the benefits of its programs. In addition, the agency needs to improve its administrative and operational controls in certain areas. The agency also could take advantage of streamlining opportunities available to it. Finally, the agency did not always meet its statutory reporting requirements.

Respectfully submitted,

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Table of Contents

Summary **S-1**

Introduction **1**

Chapter 1

The Trade and Commerce Agency Needs to Better Measure the Benefits of Its Programs 7

Chapter 2

The Trade and Commerce Agency Needs To Improve Its Administrative and Operational Controls in Certain Areas 29

Chapter 3

Possible Streamlining Opportunities Available to the Trade and Commerce Agency 47

Chapter 4

The Trade and Commerce Agency Did Not Meet All Its Statutory Reporting Requirements 53

Chapter 5

Recommendations 59

Appendix

Description of Programs and Activities Administered by the Trade and Commerce Agency 63

Response to the Audit

Trade and Commerce Agency 71

California State Auditor's Comments on the Response by the Trade and Commerce Agency **81**

Summary

Audit Highlights ...

While the agency has developed management plans for its programs, it needs to better measure the benefits derived. For example:

- ☑ ***Benchmarks or targets were not always established.***
- ☑ ***Results were not always measured when benchmarks were used, or targets were set so low that they were easily met.***

Further, the agency needs to improve its operations by developing and following policies and procedures to guide, monitor, and oversee its programs.

Finally, the agency should take advantage of opportunities to streamline certain of its operations.

Results in Brief

This report presents the results of the California State Auditor's comprehensive performance audit of the Trade and Commerce Agency (agency). It is responsible for economic development in the State. To meet this responsibility, the agency administers programs designed to ensure that the State's efforts and expenditures in various trade, investment, and tourism activities are effective and efficient, and foster the State's reputation as a source of high-quality, cost-effective goods and services. Program activities include promoting business development, growth, job creation, and retention. In addition, the agency develops and oversees international trade policy and marketing through its foreign trade, export, and investment programs. Our review focused on whether the agency's planning efforts, management systems, and organizational structure for carrying out its mission are effective and efficient. Specifically, we noted the following:

- The agency does not have an overall strategic plan. However, it has established management plans for each of its offices and programs. Although much has been done through the agency's planning efforts, more complete and consistent planning efforts are needed. The management plans do not reflect an integrated process that encompasses all the necessary elements of effective planning and reporting to properly manage its resources. For example, we noted some instances where no benchmarks or anticipated targets were established, other instances when results were not measured against benchmarks, and still others where benchmarks were set at such low levels that achievement was easily met. Further, some plans reported results that were not related to any particular goal or objective. Finally, we found that some of the benefits and outcomes reported by the agency may be more reliable than others and its follow-up efforts to update reported results are generally ineffective.

- The agency needs to improve its administrative and operational controls in certain areas. For example, the Office of Small Business has not been proactive in providing needed guidance to and monitoring of some of the programs it administers. Specifically, the Office of Small Business has not provided approved and updated policies and procedures to the eight small business development corporations it contracts

with to administer the Loan Guarantee Program, it has not ensured that it properly carried out its monitoring responsibilities for the Loan Guarantee Program or the Small Business Development Center Program, and it has not ensured that it is receiving accurate management information for its Small Business Development Center Program.

Additionally, certain operational policies and procedures need to be addressed by the Office of Business Development. Specifically, the Sudden and Severe Economic Dislocation Revolving Loan Program did not comply with all of its loan requirements, and the Old Growth Diversification Revolving Loan Fund program needs to address future monitoring responsibilities.

Further, the Office of Strategic Technology did not have a monitoring process in place to review federally required audits of subrecipients.

Finally, the agency needs to strengthen its administrative controls to prevent contractors, grantees, and other agencies from beginning work before approval and paying for services that are rendered after the term of the agreement has expired.

- Several opportunities are available to the agency to streamline its operations. We found certain instances where the agency may not be fulfilling its mission in the most effective and efficient manner. Specifically, one of the agency's programs could better focus its efforts on unmet needs, another program appears unsuited to the agency's mission, and efforts among several programs in one division appear to be duplicated.

- The agency did not meet all its statutory reporting requirements. Statutes required the agency to submit 21 reports to the governor and the Legislature for fiscal year 1994-95 activity. However, it did not prepare 4 of the 21 required reports. Further, 2 of the reports it did submit did not address all the topics required and 4 other reports were submitted after the date required in the statutes.

Recommendations

To ensure that the diverse programs and activities administered by the agency demonstrate their worth and perform at their optimal level of efficiency and effectiveness, the agency needs to take the following actions:

- Provide guidance to its management team responsible for planning on how to develop an integrated approach that will yield high-quality, consistent management information;

- Develop plans that include all the fundamental elements, including establishing goals and objectives supporting a well-defined mission, defining performance measures and setting challenging benchmarks for expected outcomes or benefits linked to all appropriate objectives, measuring the results of planned operations against the benchmarks to evaluate performance; and resetting benchmarks where necessary;

- Use the management information supplied from such an integrated planning approach to optimize its allocation of resources and to develop its annual budget;

- Develop a consistent method to follow up and document client-supplied information and consider verifying some of the inherently less reliable client-supplied information on a sample basis; and

- Use the follow-up information to refine the results reported to management, the Legislature, and others interested in the agency's activities.

To ensure that the agency's offices and programs are functioning as intended, management needs to improve its administrative and operational controls and take the following actions:

- Develop formal policies and procedures related to guiding, monitoring, and overseeing its programs where needed; and

- Ensure that established policies and procedures are followed.

To take advantage of the streamlining opportunities available to it, the agency should take the following actions:

- The California Economic Development Financing Authority should refocus its efforts toward identifying and providing for needs not currently being met by other financing sources;

- Continue its efforts to divest itself of the Dry Cleaning Plant Registration Program; and

- Reengineer or consolidate loan officers' overlapping duties relating to reviewing and approving loans.

To meet all its statutory reporting requirements, the agency should ensure that:

- All statutorily required reports are submitted by the due date and include all topics required by statutes. If the agency does not believe that current reporting requirements are appropriate, it should request that the statutes be modified.

Agency Comments

The agency generally concurs with our findings and suggestions as to how it can improve its performance. However, the agency disagrees with some of the points we make in our report. For example, the agency disagrees with our characterization of its efforts to follow up on the initial estimates provided by its clients.

Introduction

Background

The Trade and Commerce Agency (agency) was created in 1992 to focus the State's efforts on economic development and job creation in an increasingly competitive business environment.

The agency's mission is to:

- Ensure that the State's efforts and expenditures in various trade, investment, and tourism activities are effective and efficient; and

- Foster the State's reputation as a source of high-quality, cost-effective goods and services, including tourism destinations.

To accomplish its mission, the agency:

- Promotes business development, growth of emerging industries, and job creation and retention; and

- Develops and oversees international trade policy and marketing through its foreign trade, export, and investment functions.

The Agency's Organization

The agency's responsibility is to provide leadership, advocacy, coordination, and direct assistance through its specific programs to accomplish its overall mission. These diverse programs range from promoting tourism to issuing loans to local fishing fleet operators. Programs are conducted by various offices, with some offices having responsibility for more than one. Many of the programs have limited staff, including several with only one staff person. To demonstrate the diversity of the agency's programs, as well as the staffing resources committed to each program, we developed the organization chart shown in Figure 1 of the Appendix. The Appendix provides a description of each of the programs administered by the agency.

The agency is comprised of three divisions supported by the administration and finance and policy and planning groups. In fiscal year 1995-96, the agency estimates that it will spend approximately $86.5 million on its programs, including $42 million for state operations and $44.5 million for local assistance. The Economic Development Division, which is the largest, expects to spend $64.6 million of the $86.5 million. This division was established to create jobs and business growth and to provide resources and technical support to various local or regional communities to assist them in attracting new businesses and retaining old businesses.

The agency plans to spend $11.6 million during fiscal year 1995-96 for its International Trade and Investment Division. This division was established to increase California's share of employment from foreign investment in the United States, to assist California companies in gaining or increasing market share in foreign markets, and to create favorable public policy and awareness regarding the benefits of international trade and foreign investment in the State. The agency expects to spend $7.3 million on its Division of Tourism. This division was established to create jobs and tax revenues for California by stimulating economic activity through increases in the expenditures made by tourists. The Division of Tourism operates one program and has not established multiple offices. The agency expects to spend the remaining $3 million on its various support offices.

The Agency Has a Variety of Missions

Two of the agency's three divisions operate many programs within multiple offices. Each division has developed its own mission statement, as have each of the offices and programs the divisions administer. The Economic Development Division has ten offices including four regional offices. Budgets for two of these offices—the Office of Small Business and the Office of Business Development—total $48.5 million, 75 percent of the division's total budget.

The mission of the Office of Small Business is to deliver financial and consulting resources to entrepreneurs to ensure the successful establishment and growth of small businesses in California. Its mission includes serving the needs of small businesses in their communities and the State, as well as stimulating job creation and retention by supporting small businesses' crucial role in the prosperity of California's economy.

The Office of Business Development's mission is to provide assistance to communities in their efforts to stabilize and stimulate their regional and local economies by creating and retaining jobs, increasing the tax base, and creating a more diversified industry base.

The International Trade and Investment Division has 12 offices including 8 international field offices. The Office of Export Development, the Office of Foreign Investment, and the 8 international field offices comprise $8 million, 69 percent of the division's total budget.

The mission of the Office of Export Development is to expand California's job base and its competitiveness in the global economy by assisting California companies, particularly those that are small- and medium-sized, to enter international markets, and by promoting, facilitating, and supporting California exports worldwide. The Office of Export Development's mission also includes introducing export-ready California companies to agents, distributors, representatives, and direct customers overseas.

The Office of Foreign Investment's mission is to lead California's effort in attracting, retaining, and expanding direct foreign investment in the State. This includes serving as California's "one-stop" shop that foreign corporations, their California affiliates, and foreign consuls and their advisors can rely on for prompt, accurate information and tactical support regarding establishing their manufacturing plants, headquarters, representative offices, or research and development facilities in California.

The eight international field offices have similar missions that include creating new jobs in California through increasing export sales of California manufacturers to foreign markets and promoting an increase in direct investments made by foreign companies in California.

Scope and Methodology

The Bureau of State Audits was requested by the California Legislature and through language in the Supplemental Report of the 1995-96 Budget Act to perform a comprehensive performance audit of the Trade and Commerce Agency with special emphasis on economic development, international trade and investment, and tourism. We focused our efforts and recommendations on areas that would best contribute to improvement of agency operations.

To gain an understanding of the agency's responsibilities and the environment in which it operates, we reviewed the laws, rules, and regulations relevant to the agency in general and to the audit mandate in particular. We selected offices and programs for review by interviewing staff and analyzing background materials, annual plans of operation, program budgets, the role of offices or programs within the agency, and the potential that each area had for overlap and duplication or ineffectiveness. We interviewed additional staff in the Economic Development Division, International Trade and Investment Division, and the Division of Tourism, including managers of the programs selected for review. We also interviewed agency managers in the Administration and Finance Group as well as executive management. The state auditor recently issued a report entitled "Trade and Commerce Agency: The Effectiveness of the Employment and Economic Incentive and Enterprise Zone Programs Cannot Be Determined" (November 1995). We did not review the Enterprise Zone program as part of this audit.

To evaluate the efficiency and effectiveness of the agency's planning efforts, as well as its management systems and organizational structure for carrying out its mission, we interviewed executive management, reviewed annual plans of operation, and identified missions, goals, objectives, and performance measures. We interviewed the division deputies and program managers to obtain additional information relevant to the missions, goals, objectives, and performance measures for the major programs and offices reviewed. We also verified selected outcomes reported by these programs and offices. We considered the benefits and related costs of the programs, identified the sources and uses of the agency's funds, and determined whether the agency had complied with applicable restrictions.

To determine if the agency's programs operated as intended, we reviewed four major program areas (the Division of Tourism, the Office of Business Development, the Office of Small Business, and the Office of Export Development). Specifically, we selected and performed a comprehensive case study review from each of these four major program areas. Each case study review included assessment of the program staff's consistency in the use of established procedures, compliance with significant program requirements, and appropriate supporting documentation for claimed successes. For two of the case studies related to loan programs, we also reviewed the agency's efforts to ensure borrowers complied with qualifying restrictions or requirements. In addition, we interviewed the borrowers to determine whether the program was a help or hindrance in meeting their needs.

To determine compliance and assess the content of reports provided to the Legislature, we reviewed laws and regulations relevant to reporting requirements. In addition, we requested the

reports required for activities of the last fiscal year and compared the contents with the requirements of the related law or regulation. We also determined if the reports were promptly submitted.

Finally, we reviewed the agency's contracts, interagency agreements, and grant agreements for the 1994-95 fiscal year to determine compliance with relevant state and federal laws and regulations.

Chapter 1

The Trade and Commerce Agency Needs to Better Measure the Benefits of Its Programs

Chapter Summary

A key part of the Trade and Commerce Agency's (agency) mission is to ensure that the State's efforts and expenditures in various trade, investment, and tourism activities are effective and efficient. The Trade and Commerce Agency has a less tangible mission and impact than many other agencies. Therefore, it is critical that the agency take all available steps to demonstrate its worth and effectiveness. One of the steps the agency can take to ensure that the State receives the maximum return on its investment is to properly plan for its programs' and offices' activities and establish appropriate methods for measuring the value of each.

The agency does not have an overall strategic plan. Instead, it has established management plans for each of the offices and programs that we reviewed. Each of the plans addressed, in various ways, what the offices and programs were trying to do and how they planned to do it. However, while much has been done, more complete and consistent planning efforts are needed. Generally, the programs' and offices' plans do not reflect an integrated process that encompasses the necessary elements of effective planning and reporting to properly manage agency resources.

Additionally, measurement tools were used inconsistently. For example, we noted some instances where no targeted benchmarks were established, other instances in which results were not measured against benchmarks, and still others where benchmarks were set at such low levels that achievement was easily met and performance was not challenged. Benchmarks or anticipated targets are tools or indicators to assess the actual impact of an agency's actions. A benchmark or target provides a means for quantified comparison between the actual result and the intended or benchmarked result. These comparisons provide important information for management to use in determining whether programs are operating as intended and whether resources are allocated appropriately.

Further, we found that the results achieved for some plans were not related to the goals and objectives established. Additionally, one division's plan focused on the level of effort it expends on output rather than focusing on the outcomes or benefits associated with those efforts. Outputs are the goods and services that the division produces, and outcomes are the impacts made as a result of the goods and services being produced. Finally, we found that some of the benefits and outcomes reported by the agency are more reliable than others and agency follow-up efforts to update reported results are generally ineffective.

Because agency management makes resource allocation decisions based on the information that it receives from its various programs and activities, it needs high-quality, consistent information provided by an integrated approach containing all the fundamental elements of effective planning to make good decisions and to optimize its allocation of resources.

Strategic Planning Is Essential for Managing a Diverse Organization

Strategic planning maps an explicit path between the present and a vision of the future.

Strategic planning is a long-term, future-oriented process of assessment, goal-setting, and decision making that maps an explicit path between the present and a vision of the future. Essential elements leading to sound strategic planning include:

- Analyzing the planning environment to identify strengths, weaknesses, problems, and opportunities;
- Defining the mission and formulating goals consistent with the mission;
- Identifying key issues relating to the mission and the activities planned for;
- Establishing priorities among the goals and allocating resources accordingly;
- Defining the objectives necessary to achieve each stated goal;
- Establishing time lines and action plans to complete each objective;
- Defining benchmarks or targets for each appropriate activity; and
- Measuring the results of planned operations against the benchmarks to evaluate performance and reset targets as necessary.

A strategic plan should focus on the outcomes or benefits derived from the efforts expended rather than on the efforts themselves. A successful planning process provides many benefits to both the agency and those clients the agency serves. For example, as an agency clarifies its purpose and direction, it will develop a stronger agency identity. Strategic planning will improve an agency's ability to anticipate and accommodate the future by identifying issues, opportunities, and problems. Good planning will also enhance decision making at both the operational and executive management levels because of its focus on results. Further, planning efforts geared toward outcomes or benefits explicitly emphasize client satisfaction. Moreover, successful strategic planning provides needed information to guide managers in making resource allocation decisions and establishes a basis for measuring the success of the agency's activities. Finally, the fundamental concept underlying strategic planning is its dynamic nature. The planning process is not a one-time project that, once completed, remains static. Instead, it should be an iterative process that is refined and refocused as performance is measured, targets are reset, and new information becomes available.

A strategic plan should focus on outcome rather than effort.

To effectively manage its diverse offices and programs, it is essential that agency management ensure that its planning efforts are of the highest caliber, are consistent, and yield useful information to aid in decision making.

The Planning Approach Lacks Coordination and Consistency

The agency does not have a unified strategic plan. According to the agency secretary, the executive staff made a conscious decision to segment the planning function by delegating it to each division deputy secretary (deputy) because of the diversity of the programs that the agency administers. The secretary stated that delegating the planning function promoted a sense of ownership among the division deputies and directors and allowed for the significant differences in the three major divisions. As a result, individual plans have been developed for each division's areas of responsibility. Because no set format or guidelines were provided to the deputies, the content and level of detail in each plan is different, and many lack certain critical elements to make them more meaningful and useful for management decision making and resource allocation.

Because the agency has no set planning format or guidelines, the content and level of detail of the agency's more than 50 plans vary.

Because the agency secretary chose a very "flat" organizational structure instead of creating different departments, which she felt would increase the size of the bureaucracy, three deputy secretaries are responsible for the operations of the 22 offices and 17 programs administered by the agency. As a result, two of the three division deputies each have at least ten functional areas

reporting to them, with some functional areas administering multiple programs—each having its own plan. In total, the agency prepares more than 50 different plans for its various operations. These vary from planning how to increase the number of people who travel to and within California to planning how to assist private sector businesses by streamlining the regulatory process for obtaining permits.

The Agency Has Made Efforts To Plan and Demonstrate Achieved Benefits

It is apparent that the agency has expended substantial efforts to plan for its respective offices and programs and to demonstrate the benefits achieved. We reviewed the planning efforts for the management plans of one division, plans for 14 programs administered by 2 offices within another division, and the plans for 6 offices of a third division. All of these offices and programs currently have some type of planning document. Each addresses, in various ways, what the offices or programs are trying to do and how they plan to do it. When possible, we reviewed plans relating to the 1994-95 fiscal year so that we could study the entire planning horizon as well as the outcomes. We compared the 1994-95 fiscal year plans to the 1995-96 plans to see if there were improvements. However, two of the offices and two programs we reviewed did not have management plans for the 1994-95 fiscal year and another four programs were created or reorganized during or subsequent to that year. In these cases, we only reviewed management plans for the 1995-96 fiscal year.

In addition, we reviewed other documents the agency prepared that addressed the results and benefits of the offices and programs. In these documents, the offices and programs generally list numerous benefits and successful outcomes achieved. In some instances, these are quantifiable results. In many other instances, however, the agency communicates its successes through anecdotal cases. For example, the Loan Guarantee Program administered by the Office of Small Business to provide loan guarantees to lenders on behalf of small businesses reported on one such business success in 1994. Two former IBM employees converted their combined personnel and sales experience to become owner-operators of a Mrs. Fields Cookies franchise in 1994. The original franchise location was purchased using a combination of the proceeds from the sale of the couple's home and their personal savings. When an opportunity arose to expand to a second location, the couple sought a small business term loan to provide needed working capital and cover expansion costs but were unable to obtain conventional bank financing. They then applied for and were granted a loan guarantee from the Loan

Guarantee Program. The business has since expanded and created six part-time jobs, while maintaining a profitable operation.

In another instance, the international field office in Mexico within the International Trade and Investment Division reported on its success during 1995 in assisting a Los Angeles-based manufacturer to increase its export sales to Mexico. Specifically, the Mexico field office reported assisting a manufacturer of industrial casters, wheels, and polyurethane products in locating potential manufacturer representatives for its products in Mexico. The California company is now doing export business with a company in Mexico as a direct result of the information and trade leads supplied by the Mexico field office. The manufacturer reported that the office personnel of the field office were courteous in responding to its requests and that all the information supplied was current and very useful in its business ventures in Mexico. By expanding its export sales into Mexico, the company anticipates an increase in annual sales of at least $500,000 that will generate ten new California jobs.

Opportunities to increase the effectiveness of planning efforts and improve methods to demonstrate worth exist throughout the agency.

Such information can be of value and, depending on the nature of the activity, may sometimes be the only way for the agency to demonstrate success. However, based on our review, we believe that opportunities exist throughout the agency to increase the effectiveness of its planning efforts and the methods it uses to demonstrate its worth.

The Agency's Efforts To Measure Its Attainment of Goals and Objectives Are Incomplete and Inconsistent

Although some offices and programs were better than others, none of the plans or related documents we reviewed indicated that the offices or programs had planned for their operations using an integrated and complete process that encompassed all of the essential elements of effective planning.

In addition, we noted considerable inconsistency among the plans. For instance, the management plan for the field office in Germany was quite thorough—containing well-linked goals and objectives that supported the mission, stating clear time lines for attaining objectives, and establishing benchmarks for the most significant activities. However, other plans, like the one for the field office in Japan, did not have well-linked goals and objectives, did not establish benchmarks for some of its significant activities, and reported outcomes that were not linked to any specific goal or objective.

While some planning efforts were better than others, none of the plans included all the fundamental elements of sound planning.

Overall, we found that while some of the planning efforts were better than others, none of the plans were consistent in including all of the fundamental elements of sound planning. As shown in Table 1, each of the plans we reviewed was missing one or more essential elements, such as establishing benchmarks or adjusting them to challenge performance and developing goals and objectives that link to all the outcomes reported.

In the absence of an overall strategic plan and in light of the numerous and diverse offices and programs that the agency administers, it is even more important that the individual plans reflect a consistent approach so that the value of the information conveyed to management is of the highest quality, identifying both strong and weak performing activities that will aid decision making and resource allocation among the agency's diverse activities.

Some Plans Did Not Establish Benchmarks

The agency's plans generally established goals and objectives but lacked the elements necessary to measure progress.

While the plans demonstrated a certain level of proficiency in establishing goals and objectives, generally they did not include all the necessary elements to effectively measure the office's or program's progress in meeting those goals and objectives. For example, the offices or programs did not always establish benchmarks for their objectives when it was appropriate to do so. Specifically, although clear goals and objectives were established for the Mexico field office, it has no means to determine the results of some of its efforts. The field office established an objective of creating solid working relationships with the various Mexican states as a means of increasing the level of California exports. Although the field office targeted seven to ten states to build relationships with, it did not set benchmarks associated with building those relationships such as the number of contacts to be made, the number of projects that would result, or the expected level of export sales that would come from its efforts.

The same field office expressed the goal of strengthening commercial relations between California and Mexico, Central America, and South America. Two of the objectives for reaching this goal were to locate distributors and importers for California products and to encourage joint ventures between businesses located in Mexico and California. However, the field office did not set benchmarks for the number of distributors and importers it would locate and what it expected would come from the effort or the number of joint ventures it expected to result. Generally, all of the plans we reviewed lacked benchmarks for one or more objectives for which it was appropriate to establish quantifiable expectations.

Table 1

A Review of Selected Plans for the Trade and Commerce Agency

	Did Not Establish Benchmarks for All Appropriate Objectives	Did Not Establish Benchmarks for Significant Objectives	Did Not Measure Results Achieved Against Benchmarks	Established Benchmarks Did Not Challenge Performance	Reported Results Not Related to Goals or Objectives
ECONOMIC DEVELOPMENT DIVISION					
Office of Small Business					
Small Business Development Center Program	✓			✓	
Dry Cleaning Plant Registration Program			e	e	e
Loan Guarantee Program	✓	✓			✓
Disaster Loan Guarantee Program	✓	✓			✓
Repair of Underground Storage Tank Loan Program	✓	✓			
Hazardous Waste Reduction Loan Program	a	a	a	a	a
Fishing Fleet Energy Retrofit Loan Program	✓c	✓c	✓c	c	
Office of Business Development					
Old Growth Diversification Revolving Loan Fund	✓		b	✓	
Sudden and Severe Economic Dislocation Revolving Loan Program	✓		b	✓	✓
Rural Economic Development Infrastructure Program	✓		✓	✓	
California Economic Development Financing Authority	✓		b	✓	✓
California Main Street	✓	✓	✓	f	✓
Public Finance Program	✓c	✓c	✓c	c	d
Defense Conversion Program	✓	✓	d	d	d
INTERNATIONAL TRADE AND INVESTMENT DIVISION					
Office of Foreign Investment	✓		✓		
Office of Export Development	✓	✓	✓		
Hong Kong International Field Office	✓	✓	✓	d	
Japan International Field Office	✓	✓	✓		✓
Germany International Field Office	✓		✓		
Mexico International Field Office	✓	✓	✓	d	✓
DIVISION OF TOURISM	✓	✓	✓		✓

[a] Program did not have money to loan during review period; thus, it did not have a fully developed plan.

[b] Measured some results against established benchmarks.

[c] Program did not set any benchmarks.

[d] Office/program has not reported enough results linked to goals or objectives to make this determination.

[e] Program did not report on results.

[f] We could not determine because reported results were not linked to benchmarks established.

Some plans did not include benchmarks for even the most significant activities. For example, in its 1995-96 fiscal year plan, the Office of Export Development states that part of its mission is to expand California's job base by assisting small- and medium-sized exporters to enter the international market. However, while this office reported its success in generating almost $56 million in additional export sales in 1995, it did not establish any benchmarks for the level of export sales it expected to achieve. Consequently, neither the program manager nor the agency has the tools needed to evaluate whether $56 million is a reasonable result, how well the program did in reaching its goals and objectives, and what activity or activities were the most effective so as to make the best use of the office's resources in the future.

In another example, the Office of Small Business administers the Loan Guarantee Program whose mission is to promote the economic development of small businesses in California by providing capital, management assistance, and other resources. One of the goals of the Loan Guarantee Program, and one that the Office of Small Business reports results for, is helping small businesses become independent of the program when future lending needs arise. For instance, the Office of Small Business reported that for the 1994-95 fiscal year, the Loan Guarantee Program "graduated" 148 small business borrowers from the program. However, the office did not establish any benchmark for the number of borrowers it expected to graduate from this program for that year. Had it established a target of expected graduates based on the activities that it planned to conduct, the office could better evaluate how successful those activities were in accomplishing the goal. The Office of Small Business has since established a target for this goal in its 1995-96 fiscal year plan.

Without benchmarks, the agency has no basis to evaluate whether it is achieving the best results attainable.

As another example, the field office in Hong Kong included goals in its 1995-96 fiscal year plan to increase the market for California exports in China and Southeast Asia and increase the level of Chinese and Asian foreign investment made in California. In reporting on its results, the field office reported its success in increasing exports by $4.1 million and foreign investment by $4.8 million. Again, the plan did not establish benchmarks for either the expected increase in the amount of California exports or foreign investment in the State as a result of its efforts. While the figures reported may seem significant, without targets the office cannot measure its relative level of success or its progress in penetrating targeted markets and thereby concentrate its efforts on those areas with the biggest payoff.

When benchmarks are not established to express quantifiable expectations, the agency does not have a basis by which to effectively evaluate whether it has maximized the State's investment in achieving the best results attainable.

Results Were Not Measured Against Established Benchmarks

In instances when the office or program did establish benchmarks, the reporting methods did not reflect an integrated approach in which results were measured against benchmarks. For example, of the 21 plans we reviewed, 18 set benchmarks for at least one objective. However, of the 18 plans that did set benchmarks, 14 made few or no comparisons between the benchmarks they established and the results they achieved. For instance, in its 1994-95 fiscal year plan, the Office of Foreign Investment set benchmarks of assisting with $80 million of foreign investment transactions and generating 400 jobs from its investment activities. Based on an average of the office's reported results for the 1994 and 1995 calendar years, it surpassed both of its benchmarks, assisting with $124 million in foreign investments that generated 758 jobs.

Of the 18 plans that set benchmarks, 14 made few or no comparisons between the benchmarks and the results achieved.

However, in reporting on its results for the previous year, the office never referred to the benchmarks it had established. While it may informally make such comparisons in resetting its benchmarks for the next year, the office is missing an opportunity to provide a much more effective way of communicating its results and justifying future resource requests. Without the inclusion of such assessments of performance, program managers, executive management, the Legislature, and others interested in the activities of these offices and programs have an incomplete picture of how effectively they are meeting their goals and objectives. Furthermore, some of the plans were based on a fiscal year time period but results were reported on a calendar year basis. When results are not integrated with the same time period as the plan, measuring and evaluating performance become much more difficult.

Certain Benchmarks Require Adjustment To Challenge Performance

In the eight different plans containing benchmarks to measure significant activities, the targets set frequently failed to challenge performance, as the results achieved for several activities far exceeded the benchmarks established. For example, four of the programs administered by the Office of Business Development—the Old Growth Diversification Revolving Loan Fund (Old Growth) program, the California Economic Development Financing Authority (Financing Authority), the Sudden and Severe Economic Dislocation Revolving Loan Program (Sudden and Severe), and the Rural Economic Development Infrastructure Program (REDIP)—all reported certain results that were well above what was targeted for these activities.

In addition, the Small Business Development Center Program administered by the Office of Small Business reported results that significantly exceeded the targets established.

The Old Growth program within the Office of Business Development provides revolving fund loans to businesses located in rural areas that are dependent on a natural resource, such as a logging community. The Old Growth program has used a benchmark of creating or retaining at least one job for each $35,000 loaned for both the 1994-95 and 1995-96 fiscal years. However, in 1994-95, the program reported it created or retained one job for every $6,533 loaned. At that time, the benchmark set as an incentive for job creation/retention should have been reevaluated and increased. Instead, the benchmark remained the same at one job for every $35,000 loaned while results for the first four months of the 1995-96 fiscal year indicate that the program is creating one job for every $9,849 loaned.

While five of eight programs significantly exceeded targets, we believe the goals are too low and need adjustment.

In addition, three other programs within the Office of Business Development that have recently been established or redesigned are reporting results that indicate benchmarks set to encourage job creation are too low and need adjustment. Specifically, the Financing Authority provides financing for public and private development projects with industrial development bonds. In its 1995-96 fiscal year plan, the Financing Authority established a benchmark of creating one job for every $50,000 in industrial development bonds issued by the program. However, in the first six months of the 1995-96 fiscal year (the first year that the bonds were issued), the Financing Authority reported attaining a level of one job for approximately every $23,000 in bonds issued.

Furthermore, the Sudden and Severe program, which provides start-up and working capital loans to businesses to stimulate job creation in economically depressed areas of the State, also set an unchallenging benchmark for creating jobs. In its 1995-96 fiscal year plan, the Sudden and Severe program established a benchmark of creating one job for every $20,000 in funds loaned. The results reported for the first seven months of the 1995-96 fiscal year indicate that the program creates one job for every $4,838 of funds loaned, more than four times the jobs to loan ratio target established, a strong indication that the program's incentive for job creation needs adjustment.

Finally, the REDIP has also set its job incentive benchmark much too low. The REDIP provides loans to rural local governments to fund the construction, rehabilitation, or acquisition of certain types of infrastructure, such as sewer and water facilities, as a means of attracting and retaining businesses in these locations. The REDIP has used a benchmark of creating or retaining one job for every $50,000 in loaned funds since at least the 1994-95 fiscal year. The REDIP reported it had created or retained one job for

every $2,288 loaned since September 1994. Clearly, the jobs incentive benchmark set by the program is not synchronized with its results and needs adjustment.

The program managers for both the Old Growth and the Sudden and Severe programs stated they established their respective benchmarks by modeling them on federal benchmarks or guidance. The program manager for the Financing Authority stated he patterned the benchmark he used after the policies of a commission of the State Treasurer's Office. Finally, the program manager for the REDIP stated that the benchmark used is based on statute. We believe the programs should consider such statutory requirements or federal guidance to be the minimally acceptable level of performance. Such requirements do not preclude the programs from administratively setting more challenging benchmarks.

The program managers stated they established benchmarks using federal or state guidelines. However, these requirements would not preclude setting more challenging targets.

Another program that needs to adjust its established benchmarks is the Small Business Development Center Program. The program is administered by the Office of Small Business through its contracts with small business development centers (centers). The centers provide business counseling, referrals, and training activities to small businesses. In some instances, the centers also provide assistance to small businesses in the areas of technological transfer, international trade, and government procurement.

Individual benchmarks were established with each of the centers through their individual 1994 calendar year contracts with the Office of Small Business. Benchmarks were established for the number of one-time and continuous counseling sessions provided, the number of training sessions provided, the number of business people attending the training sessions, and the number of jobs created and retained. The statewide aggregates for these benchmarks were 11,090 for combined one-time and continuous counseling sessions, 475 training sessions attended by 9,285 people, and 2,325 jobs created or retained.

However, the results reported for the Small Business Development Center Program were dramatically higher. Specifically, 20,574 one-time and continuous counseling sessions were provided—more than 86 percent greater than the target. The 1,204 reported training sessions attended by 32,131 people represented outcomes of 154 percent and 246 percent, respectively, greater than the targets. Finally, the reported number of jobs created or retained was 14,407 compared to the target of 2,325, more than 520 percent greater than the benchmark. When we asked why the results for the program varied so dramatically from the targets, the director of the Office of Small Business stated that the automated data processing system used by all the centers to report their individual performance statistics produces inaccurate data when compiling

summary performance information. We discuss this issue further in Chapter 2. However, the director also stated that the Office of Small Business recognizes the benchmarks are too low and need to be evaluated.

Additionally, the undersecretary of the agency stated that the Office of Small Business recognized the centers were consistently outperforming their established benchmarks and increased the targets for many of the centers for the 1996 calendar year contract period. He further stated that the Small Business Development Center Program benchmarks would be evaluated and renegotiated by amending the centers' contracts in the middle of 1996. We reviewed the 1996 aggregate benchmarks for the program. While results had not been reported for the 1995 calendar year at the time of our review, 1994 results indicate that the benchmarks still may be too low. For example, when we compared the 1994 results to the 1996 benchmarks, the results surpassed the counseling sessions benchmark by 42 percent, the training sessions benchmark by 23 percent, and the training attendance benchmark by 92 percent.

The agency recognized one program consistently outperformed its benchmarks and needs to be reevaluated.

When targets that are easily attainable and do not challenge performance are initially established, staff responsible for those activities, including contractors, may not be optimizing their efforts.

One Division's Plan Was Not Focused on Outcomes or Benefits

One division's plan established several benchmarks relating to planned activities. However, the benchmarks focused on the level of effort the division expends on various outputs rather than on expectations regarding outcomes or the benefits associated with planned activities. Outputs are the goods or services that the division produces, whereas outcomes are the impacts made as a result of the goods or services being produced.

Specifically, the Division of Tourism established a number of benchmarks to measure its level of output but established few such benchmarks to measure its outcomes. For instance, to reach one of its goals, the division developed an objective of publishing and distributing the Golden California visitor guide. As a means of measuring its performance, the division established an expected benchmark of publishing 300,000 visitor guides. Although this benchmark addresses the level of output the division expects to achieve, it does not address the desired outcome or benefit for its investment in this activity, such as the additional tourists who would visit California or the amount they would spend while visiting the State as a result of receiving and being influenced by the visitors guide.

According to the division's deputy secretary, the division does not set results-oriented benchmarks because it is difficult to tie tourism successes or failures to anything specific. The deputy secretary cited the example of an earthquake in Los Angeles causing tourists to avoid traveling to California no matter how good the division's marketing effort was. While we agree that isolating the effect that the division has on tourism trends is difficult, more can be done.

If evaluation of a project can be achieved after the fact, it should be possible to predict results in advance as well.

For example, the division hired a consultant to evaluate a major advertising campaign it conducted in the spring of 1994. Some of the objectives of the consultant's study were to evaluate the effectiveness of the advertising campaign in creating a heightened awareness of California as a desirable tourist destination, in generating interest in visiting California, in creating an intention to visit, and whether the campaign resulted in a positive return on investment. Based on a methodology of conducting surveys in specific advertising target markets both before and after the campaign, the consultant projected after the completion of the campaign a specific number of visitors who would visit California in 1994 and 1995 as a direct result of the advertising campaign, the estimated amount that they would spend while visiting, and the projected state taxes that would result because of this new spending. The consultant concluded that the division's investment of $3 million for the campaign would bring an estimated 616,500 new visitors who would spend approximately $314 million while visiting California, resulting in new state taxes of almost $12 million for an overall return of $4 for every state dollar spent. We believe that if such an analysis can be conducted after the fact, it should be possible to establish expected benchmarks in advance of such a campaign.

Without setting outcome-oriented benchmarks for its more significant activities, the division does not have all the tools it needs to evaluate how successful it is in achieving established goals and whether the investment of funds in the program is worthwhile. The division should strive to perform only those functions where value is added for the taxpayer, either because an essential service is involved that cannot be performed by the private sector or the division has a competitive advantage over the private sector in providing its service.

Some Plans Reported Results That Were Not Related to Goals or Objectives

Eight of the plans we reviewed reported results for a variety of outcomes that were not linked to any specified objective, and in some cases, were not even linked to an expressed goal. When outcomes are unconnected with specified objectives and goals,

When outcomes are not connected to objectives and goals, the results may not coincide with what management intended to accomplish.

the results achieved may not coincide with what management intended and also may indicate the inefficient use of resources. For example, the Loan Guarantee Program is administered by eight small business development corporations (corporations) under contract with the Office of Small Business. The Loan Guarantee Program provides guarantees to local lenders for loans made to small businesses that are unable to find conventional financing.

The Loan Guarantee Program tracks and reports on the number of borrowers who "graduate" from the program each year by paying off their guarantees, the number of jobs created or retained each year as a result of receiving loan guarantees, the annual default rate among borrowers, and the amount of sales and use taxes paid by participants of the program each year. However, only one of these reported results was linked to an expressed goal of the program—to help small businesses graduate from the program—and none were linked to objectives developed to describe how the results would occur. While all of these results may be important to the program, when they are not connected to the plan's expressed goals and objectives, it is unclear whether the outcomes were the result of the corporations' efforts or that the results were the ones intended.

We found another example of failing to fully develop goals and objectives in the Sudden and Severe program. As we described earlier, the Sudden and Severe program is a revolving loan fund that provides start-up and working capital loans to businesses to stimulate job creation in economically depressed areas of the State. The Sudden and Severe program, administered by the Office of Business Development, tracks and reports on the amount of private financing used in deriving a leverage factor for the loan fund, the percentage of funds loaned for fixed asset financing, the percentage of funds loaned for industrial and commercial projects, and the percentage of funding used to finance expansion, retention, and start-up projects. However, the plan did not develop any goals or objectives relating to these outcomes.

In a final example, the field office located in Japan, whose mission includes creating new jobs in the State through increasing the sales made by California exporters in the Pacific Rim and increasing the amount of investments made in California by foreign companies, failed to link its objectives with the results it reported. The office tracks and reports on how many trade and investment inquiries it responds to each year and the number of companies it works with on foreign investment activities. However, the plan did not develop any objectives that link to these reported results. While recognizing outcomes is important, not matching them to expressed objectives can lead to efforts that do not achieve desired results and can cause the inefficient use of resources.

When plan goals and objectives are not fully developed to link to each reported outcome or result, effort may be expended in pursuing activities and tracking and reporting results that do not coincide with the views of the executive management.

Some Reported Benefits and Outcomes May Be More Reliable Than Others

The agency reports a wide variety of outcomes, benefits, and impacts from its various programs each year. Some examples include the return on investment from specific advertising campaigns commissioned by the Division of Tourism; the annual California export sales and foreign investments supported by the International Trade and Investment Division; the number of trade shows and missions organized by various components within the agency; the dollar amount of loans made or guaranteed by the various financing programs administered by the agency; the number of film permits issued; the number of training or counseling sessions provided to small business people; the annual number of jobs created or retained due to the agency's efforts; and the number of business attractions, expansions, or retentions that were facilitated by the agency.

The quality of client-supplied information that the agency uses in reporting its successes varies.

Generally, the agency obtains the information it uses in reporting on its benefits and outcomes from two sources: the clients it serves and, in cases where levels of output are being reported, information sources obtained from within the agency. However, the level of reliability of the information varies. One example where the data are fairly reliable is the information the agency receives concerning its efforts to increase California's export sales. These data may come from the value of purchase orders or letters of credit securing loan guarantees granted by the agency's Office of Export Finance, from company estimates of the export sales generated from attending a trade show organized by the Office of Export Development, or company estimates of export sales that were assisted by the international field offices. While such client-provided data is subject to some error in the accuracy of the estimates provided, because there is no incentive for clients to knowingly distort the estimates they provide, it is generally reliable.

However, other information may be more susceptible to an inherent bias on the part of the client that would distort certain statistics used by the agency in reporting its success. For instance, a significant number of jobs the agency reports as being created or retained due to its efforts come from estimates provided by the clients it serves through its loan and loan guarantee programs. Unlike the Office of Export Finance's loan guarantee program described above, which uses purchase orders or letters of credit to quantify the amount of export sales

that is in turn used to compute the estimated jobs created, these other programs rely on estimates provided by borrowers on their loan applications of the jobs that will be created or retained if the loan or guarantee is approved. This client group may perceive an incentive to overestimate the number of jobs created or retained in hopes of securing an initial loan or loan guarantee or to remain in such a program. While borrowers are required to make a commitment to create or retain jobs and some of the loan programs contain provisions requiring the borrower to create or retain one job for every given number of thousands in loan funds received, the loan documents contain no penalty for a borrower who fails to create or retain these jobs or who may have overestimated the impact of the loan funds.

Businesses the agency assists in its attempts to attract them to California, or those businesses it either assists in expanding operations or in remaining in the State, are another client group that may have an incentive to be overly optimistic in estimating the number of jobs created or retained. At times, the assistance the agency provides involves working with various state and local representatives to develop an incentive package to entice a business to locate, expand, or remain in California. These incentive packages can take the form of favorable utility rates, business tax credits, relaxed regulatory permitting requirements, or other tailored incentives meeting the needs of the business being assisted. In such situations, the assisted business may exaggerate its estimate of the number of jobs it will create or retain in order to receive the incentive package being offered.

The employment information supplied by two borrowers significantly differed from comparable EDD data.

To gauge how reliable some of the client-supplied information is, we asked the Employment Development Department (EDD) to independently confirm certain employment information involving two employers. These employers represented two case studies we selected for review. One case study came from the Loan Guarantee Program and the other from a revolving loan program. In both cases, the employment information supplied by the borrowers varied significantly with the information contained on the EDD's employer files. For example, a borrower reported in the beginning of May 1993 that receiving the loan guarantee for a line of credit would result in the retention of the company's existing workforce numbering 300 and the creation of an additional 7 jobs. The same employment figures were quoted again in the beginning of November 1993 when the borrower was granted an increase in the guaranteed line of credit. However, according to the EDD, this employer reported workforce numbers of 67, 40, and 62 for the months of April, May, and June 1993. Further, workforce figures reported to the EDD by the borrower for the months of October, November, and December 1993 were 189, 204, and 26, respectively. Even allowing for seasonal fluctuations, the workforce numbers reported to the EDD by the

borrower were considerably lower than those reported to the agency and may not be reliable, thus overstating the agency's employment statistics resulting from this loan program.

In the other case study, a borrower reported in a January 1994 application for a revolving loan that receiving the loan would enable the borrower's business to retain a workforce of 91 and create 29 new full-time and 20 part-time jobs. After receiving the loan, the same borrower reported that, as of the end of September 1995, the business employed 132. However, according to the EDD, this employer reported workforce figures of 92 and 107 for November and December 1993, and 115 for January 1994. The workforce figures reported to the EDD by the borrower for August and September 1995 were 100 and 92, respectively. Again, it appears that the client reported unreliable information to the agency.

The agency does not have a process to independently verify the information supplied by its clients.

Currently, the agency does not have any way to independently verify the information supplied by its clients. According to the agency secretary, the majority of the information the agency reports on is supplied by clients. She further stated that the agency has been advised by the EDD and the Franchise Tax Board that confidentiality concerns would preclude the agency from obtaining specific independent employment or salary information from their records. Furthermore, even if such information could be obtained, the secretary stated that she thought cost could be an issue. Finally, the secretary believes that it would diminish significantly the service the agency provides if resources were reallocated to visit client locations to validate the information the client supplied.

Using information provided by the agency, we estimate that the annual client population served that may have an incentive to provide inaccurate employment information to the agency numbers around 500. We met with the chief and a manager of the Labor Market Information Division of the EDD to discuss the feasibility of obtaining independent confirmation of some of the employment information that is reported by the agency's clients. According to the chief of the division, once the EDD and the agency have an agreement in place that states such information will not be used by the agency for enforcement activities, the EDD could provide independent employment information on up to 500 employers twice a year for no more than $5,000, or $10 per employer per year. We believe this is a very reasonable price for the agency to pay in exchange for independent verification of some of the information supplied by its clients that the agency uses in reporting on its successes in creating and retaining jobs in California.

The Agency's Efforts To Follow Up on Client-Reported Information Is Generally Ineffective

While many of the offices and programs we reviewed stated that they follow up on client-supplied information, in many instances the methods used are not well documented and are rarely used to update aggregated results already reported by the agency.

Much of the follow-up with clients to obtain updated information is conducted by telephone. For example, the deputy secretary of the International Trade and Investment Division stated that both the Office of Export Development and the Office of Foreign Investment within the division update initial client-provided information through periodic telephone calls to determine if original projections concerning export sales, foreign investment, and job creation and retention have materialized. The information obtained during follow-up efforts is used to develop individual anecdotal case studies that are also reported annually. However, this follow-up information is not being used to revise the aggregate estimated results already reported. While this method of follow-up may be effective in reporting actual successes on a case-by-case basis, it is not effective in revising the aggregated estimated results currently being reported.

Current follow-up methods are effective in reporting individual successes but not in revising overall results.

For instance, as part of our review of the Office of Export Development, we requested support for the amount of additional export sales the office reported it generated. The support provided was all based on the initial estimates obtained through post-show surveys and was not adjusted to reflect any updated information that may have been gathered. In fact, when we asked for documentation of this updated information, the director of the Office of Export Development provided us a schedule of companies the office contacted by telephone. However, the telephone follow-up is used only for documenting anecdotal case studies reported on by the office and not for updating the aggregate export sales figure that is based on estimates. If follow-up efforts are not made, decisions on the relative success of a program may not be well founded. If they are made, the numbers affected should be adjusted accordingly.

Moreover, none of the outcomes or benefits reported annually by the agency that we verified were being updated by subsequent follow-up efforts. The agency reports to the Legislature, governor, and other interested parties on its successful outcomes and benefits annually. However, the manner in which most of the information is reported does not lend itself to being adjusted with follow-up information. Specifically, the agency normally reports on discrete activities and accomplishments that occurred within the last 12 months. It does not generally report on either cumulative results over time or on historical trends as part of its

management information. As most follow-up efforts are performed annually, any updated information would tend to affect the results reported in the previous year and not the results being reported currently. Consequently, much of the client-supplied information that the agency uses in reporting on its annual successes is based on preliminary estimates.

Better Management Information Would Improve the Agency's Budgeting and Resource Allocation Decision Making

Based on our review and analysis of the planning efforts discussed throughout this chapter, we do not believe that the agency is currently receiving the type and quality of management information necessary to optimally formulate its annual budget and reach fully informed decisions on how to make resource allocations among its competing programs and activities to maximize results.

As part of our audit, we reviewed the budget process used by the agency. According to the assistant secretary for Administration and Finance, the agency uses an incremental approach to budgeting. Specifically, the budgeting process begins by using the prior year's budget, called a "baseline" budget, and increasing or decreasing the baseline amounts according to the needs of each program or office for the ensuing year.

Executive staff make choices among competing requests based on their collective experience within the agency.

According to the agency secretary, each May all office directors are requested to submit "budget change proposal concept letters" outlining their additional budget needs for the coming year and to justify requests for additional resources. Once the budget concept letters are received, the secretary stated that she and her executive staff—including the undersecretary, deputy secretaries, and assistant secretaries—review them. She stated that the executive staff discuss the merits and expected outcomes contained in the concept letters and sometimes will seek additional information from their authors until final approval decisions are made. The secretary stated that the executive staff make choices among competing requests for resources based on their collective experience regarding the needs of the agency at that particular point in time. Because the agency does not formally document the basis for their resource allocation decisions, we could not assess whether resources were allocated in the most optimal manner.

We also asked the agency secretary how, using a delegated approach to planning, she was able to determine whether her deputies and directors were fulfilling her expectations regarding their respective divisions' contributions to the agency's mission.

The secretary stated that she and her undersecretary evaluated each deputy and director by measuring performance against individual plans. The secretary stated that her undersecretary holds weekly meetings with each of the division deputies and is very conversant in what the agency is trying to accomplish. The secretary also stated that each division deputy meets with his or her respective directors and managers to communicate and focus the implementation of each respective plan.

Although we recognize that the ongoing interactive process described by management is worthwhile and can provide valuable information, we believe that opportunities exist to strengthen the agency's process for allocating its resources. The agency faces special challenges when making resource decisions because of the diverse nature of its multiple responsibilities and the inherent difficulty in demonstrating the value of some of its less tangible activities. These challenges are increased by the agency's current approach to planning where each of the individual programs and offices prepares its own plan using a variety of approaches. As discussed previously, we noted a wide disparity in the content and level of detail of the various plans we reviewed. To manage the diversity, agency management needs to ensure that the planning information it receives is of the highest quality and reflects as consistent an approach toward measuring benefits derived as is possible. If agency management has that information, it is then positioned to make the necessary decisions as to how to best allocate resources among a variety of competing activities to maximize results.

Additionally, we believe the agency should reconsider the incremental way in which it currently makes budgeting decisions. Starting with the previous year's budget and making incremental changes may not be the best approach for an agency such as this one. The agency attempts to address a variety of needs which are oftentimes very dynamic in nature. What might be the best use of funds during one budget cycle because of specific critical needs or unique opportunities to make contributions could be dramatically different for the next budget cycle. Therefore, it is important that the agency's budgeting process be just as flexible and dynamic as the activities it manages. The agency should evaluate its resource needs based on what is the best way to maximize those resources in the current year without regard to what was spent in the previous year.

Starting with the previous year's budget and making incremental changes may not be the best approach for an agency such as this one.

Conclusion

The agency does not have an overall strategic plan; however, it has established management plans for each of its numerous and diverse offices and programs. Although the agency's planning efforts revealed a certain level of proficiency in establishing goals

and objectives, more complete and consistent planning efforts are needed. The various programs' and offices' plans do not reflect an integrated process that encompasses all the necessary elements of effective planning and reporting to properly manage its resources. In addition, measurement tools were used inconsistently. In some instances, the agency did not establish benchmarks and in others, results were not measured against established benchmarks. In still other instances, the agency set benchmarks at such low levels that achievements were easily met and failed to challenge performance or reported on results it achieved that were not related to the goals and objectives it established. Further, some of the information the agency receives and uses to report its benefits and successful results may not be reliable, and follow-up efforts to update the information are generally ineffective. As a result, the agency does not have all the information it needs to effectively evaluate whether each of its offices and programs has maximized the State's investment in achieving the best results attainable and, if not, to adjust resource allocations to achieve better results.

Chapter 2

The Trade and Commerce Agency Needs To Improve Its Administrative and Operational Controls in Certain Areas

Chapter Summary

In our review of the programs and activities administered by the Trade and Commerce Agency (agency), we had concerns in three areas within the Economic Development Division and concerns in one area within the Administration and Finance Group. Specifically, we noted instances where the agency lacks adequate administrative and operational controls over programs administered by the Office of Small Business and the Office of Business Development. In addition, as part of our review of the agency's compliance with monitoring requirements for the federal programs it administers, we reviewed one of the grant awards the Office of Strategic Technology made and found that it had not adequately monitored the subrecipient. Finally, we found instances in the Contracts, Grants, and Loans Office where the administrative controls did not function as intended.

For example, the Office of Small Business has not been proactive in providing needed guidance to and monitoring of some of the programs it administers. Specifically, the Office of Small Business has not provided approved and updated policies and procedures to the eight small business development corporations (corporations) it contracts with to administer the Loan Guarantee Program, has not ensured that it properly carried out its monitoring responsibilities for the Loan Guarantee Program or the Small Business Development Center Program, and has not ensured that it is receiving accurate management information for its Small Business Development Center Program.

Furthermore, the Office of Business Development needs to address certain operational policies and procedures. Specifically, the Sudden and Severe Economic Dislocation Revolving Loan Program (Sudden and Severe) did not comply with all of its loan requirements, and the Old Growth Diversification Revolving Loan Fund (Old Growth) program needs to address future monitoring responsibilities.

Finally, the agency needs to strengthen its administrative controls to prevent contractors, grantees, and other agencies from beginning work before the contract, grant, or interagency agreement is approved and paying for services rendered after the agreement has expired.

The Office of Small Business Is Not Providing Sufficient Guidance for One of Its Programs

The Office of Small Business was created to deliver financial and consulting resources to entrepreneurs, ensuring the successful establishment and growth of small businesses in California. Its mission includes serving the needs of small businesses in their communities and the State, as well as stimulating job creation and retention by supporting small businesses in their crucial contribution to the prosperity of California's economy. To accomplish its mission, the Office of Small Business administers multiple programs that provide financial, management, and technical assistance to small businesses. Refer to the Appendix for a brief description of the programs. In the following sections, we discuss problems we noted in the Loan Guarantee Program and the Small Business Development Center Program.

The agency has not provided updated policies and procedures to its Loan Guarantee Program's contractors.

The Loan Guarantee Program's primary focus is to provide loan guarantees to local lenders on behalf of eligible small businesses. The Office of Small Business administers this program by entering into contracts with eight corporations. However, it has not provided sufficient guidance to the corporations to ensure that they follow updated policies and procedures that would result in the program operating as intended. The Office of Small Business has not updated its policies and procedures manual since 1989, yet various policies and procedures of the Loan Guarantee Program have changed during that period.

The contract between the agency and the eight corporations specifies that the corporations are to perform their operations in conformity with the provisions found in Section 14000 et seq. of the Corporations Code. The contract also requires that the corporations adopt and maintain written credit policies and lending criteria consistent with the guidelines and policies issued by the Office of Small Business relating to the Loan Guarantee Program. In addition, the contract stipulates that the corporations use a credit operating procedures manual supplied or approved by the Office of Small Business.

However, according to the undersecretary of the agency, the only policies and procedures the Office of Small Business has for the Loan Guarantee Program are those that were developed in 1989. The undersecretary stated that they were never formally adopted

The only policies and procedures for the Loan Guarantee Program were developed in 1989 and never formally adopted.

because the Office of Small Business, the Small Business Development Board (board), and the corporations could not reach agreement on their final form. The board was established in part to provide advice to the director of the Office of Small Business regarding the activities of the corporations and to review and approve the contracts.

The undersecretary further stated that as of March 8, 1996, the Office of Small Business had neither formally adopted policies and procedures for the Loan Guarantee Program nor had it obtained current copies of the corporations' individual policies and procedures. The undersecretary stated he recognized the need for a policies and procedures manual for the Loan Guarantee Program and intends to develop one by the end of the calendar year. In the interim, the undersecretary stated that the Office of Small Business will request, review, and maintain copies of the corporations' individual policies and procedures manuals until such time as it develops its own approved policy manual.

We contacted the presidents of all eight of the corporations to determine what policies and procedures each was using as guidance for administering the Loan Guarantee Program. While all of the corporation presidents stated that they had a copy of the Office of Small Business's credit operating procedures manual, six of them stated they also had their own policies and procedures covering lending criteria for the Loan Guarantee Program. Of the six corporations that had their own policies, three stated that they primarily use their own policies and procedures when issuing loan guarantees, and the other three stated they use both their own and the Office of Small Business's policies and procedures. Of the remaining two corporations that do not have their own policies and procedures, one stated that it uses the Office of Small Business's 1989 policies and procedures manual. The other stated that it bases its lending criteria on past actions taken by its board of directors, federal regulations, state law, and the Office of Small Business's policies and procedures manual. None of the corporation presidents had ever been asked by the Office of Small Business for a copy of their own corporate policies and procedures manuals concerning credit criteria for the Loan Guarantee Program.

The corporations may be interpreting the Corporations Code or their own credit policies in ways contrary to the Office of Small Business's intent.

As a result, the corporations may be interpreting the Corporations Code and their own unapproved credit policies in ways contrary to the Office of Small Business's intent. For example, Section 14071(b) of the Corporations Code states that the corporation should not guarantee a loan until it determines that all proceeds are to be used exclusively in California. However, one loan guarantee that we reviewed was issued to a borrower who conducted business operations in both California and Oregon. The corporation interpreted Section 14071(b) of the code to mean that only the guaranteed portion of the loan need be used exclusively in the State. Because this area of the Corporations

Code is not clear, the corporation's interpretation may not be the same as that of the Office of Small Business. In addition, the same corporation issued loan guarantees to two borrowers who both indicated that part of the purpose for their loans was to liquidate preexisting debt. According to the unadopted credit policies of the Office of Small Business, issuing a guarantee for a loan to pay for preexisting debt is an unacceptable purpose.

Clearly, the Office of Small Business needs to provide formal policies and procedures so that all the corporations have specific guidance regarding its interpretations of the laws governing the Loan Guarantee Program. Further, the Office of Small Business needs to ensure that the corporations are administering the Loan Guarantee Program in the way it intends.

The Office of Small Business Is Not Meeting Its Monitoring Responsibilities

During our review of the programs administered by the Office of Small Business, we noted instances where it was not properly meeting its monitoring responsibilities. For example, for a two-year period beginning July 1, 1993, the Office of Small Business did not adequately monitor the Loan Guarantee Program to ensure that expenditures that were unallowable were detected. In addition, the Office of Small Business has not fulfilled its responsibility to conduct performance reviews of the participants of its Small Business Development Center Program and has not ensured that program participants have met federal audit requirements.

The Office of Small Business Has Inadequately Monitored the Loan Guarantee Program

The Office of Small Business uses three methods to monitor the performance of the eight corporations it contracts with to operate the Loan Guarantee Program. First, each corporation must have its financial statement audited each year to ensure that all its account balances are properly classified and are materially correct in amount. However, until recently, the contracts did not require that the auditor comment on whether all the expenses of the corporations were allowable according to contract terms. Second, the agency's Contracts, Grants, and Loans Office annually reviews each of the corporations' loan guarantee portfolios to ensure that the files contain all required documentation and comply with the terms of the contract. Third, for audits through June 30, 1993, the Office of Small Business contracted with the Department of

Finance to audit the funds disbursed by the corporations annually to ensure that all expenditures were allowable according to the terms of the respective contracts.

However, the Office of Small Business did not renew its contract with the Department of Finance to perform the annual audit of the funds disbursed by the corporations for fiscal years after June 30, 1993. In addition, the only audit requested since the Office of Small Business discontinued its annual audits was of one corporation and resulted in the Department of Finance questioning costs amounting to over $24,000 of the $866,611 spent during the two years under review. As a result of the discontinued annual audits and the amount of questioned costs from the review of one corporation, we raised the concern that, unless it somehow comes to the attention of the Office of Small Business, corporations could expend funds on unallowable activities and the fact would remain undetected.

In response to our concern over reduced monitoring, the agency stated it has recently expanded the role of the corporations' financial auditors in their annual audits.

In response to our concern over the reduced monitoring efforts of the Office of Small Business, the agency's undersecretary stated that it had recently expanded the role of the auditors conducting the annual audits of the corporations' financial statements to include an audit of the funds disbursed. Beginning with its 1995-96 fiscal year contracts with the corporations, the Office of Small Business requires that the annual audit of the corporations' financial statements also include an audit of disbursed funds to ensure the disbursements comply with the terms of the contract. The first audit reports under the new contract language will be due 120 days after the end of the contract period, which ends June 30, 1996. Although the Office of Small Business has expanded the auditor's role beginning with fiscal year 1995-96, the Office of Small Business did not adequately monitor the Loan Guarantee Program expenditures for a two-year period covering fiscal years 1993-94 and 1994-95.

The Office of Small Business Has Inadequately Monitored the Small Business Development Center Program

Under a cooperative agreement with the U.S. Small Business Administration, the Office of Small Business administers California's Small Business Development Center Program. The goal of this program is to stimulate the economy and promote new job opportunities by assisting in the development of small businesses and providing the following comprehensive network of services to businesses: management assistance, business education and training, and capital formation assistance. As the lead center, the Office of Small Business allocates funding to the small business development centers (centers) located throughout the State and is responsible for overseeing the

program. The agency contracts with community colleges, universities, chambers of commerce, economic development corporations, and other nonprofit entities to staff and provide administrative support for the centers.

One responsibility of the Office of Small Business is to monitor and evaluate the performance of the individual centers under contract. However, we found that this office has not followed its own policies and procedures for monitoring and evaluating the centers and, therefore, has not adequately performed its monitoring function for the Small Business Development Center Program.

The Office of Small Business conducted only 5 of the 48 performance reviews of its centers.

Section 2.50 of its policies and procedures to administer the Small Business Development Center Program specifies that the Office of Small Business will conduct semiannual on-site performance reviews of the centers. These performance reviews are designed to evaluate contractual compliance with state and federal regulations and overall program service delivery. However, instead of conducting the 2 performance reviews required for each of the 24 centers during the 1994 calendar year, for a total of 48 reviews, the Office of Small Business reported that it conducted single reviews of 5 different centers. Furthermore, of the 5 performance reviews that it reported, 3 were not complete. Only one was completed, and we could not determine if a review was conducted or a report was issued for the fifth as the Office of Small Business was unable to locate it.

According to the director of the Office of Small Business, performance reviews were given a lower priority during 1994 because of a shortage of experienced staff in the Small Business Development Center Program. In addition, the director stated that she changed the policy in 1995 requiring the Office of Small Business to conduct performance reviews of all the centers annually rather than semiannually. However, this change was not reflected in the policies and procedures for the Small Business Development Center Program. After we discussed this issue with the director of the Office of Small Business, the office updated its policy on March 27, 1996, to reflect the requirement that the centers be reviewed annually.

Despite the unofficial policy change requiring annual reviews, the Office of Small Business conducted less than half of the reviews for the 27 centers during the 1995 calendar year. Of the 13 reviews conducted, the Office of Small Business issued reports for 9 centers and completed reviews for an additional 4 centers but has yet to issue the reports.

Generally, these reviews identify problems with federal compliance, contract compliance, and the effectiveness of the center. For example, a 1995 review of one center noted inadequate compliance with federal requirements, such as failing

to submit training forms to the U.S. Small Business Administration for approval. The same review noted inadequate compliance with contract requirements, such as failing to maintain file documentation to support services provided to clients. The review also faulted the center for not being effective in reaching potential clients in the service area to provide quality business counseling to the entire business community, which the review emphasized as being the most important function of a center.

When performance reviews are not conducted, problems may exist that go undetected.

When the Office of Small Business does not conduct required performance reviews or does not complete the reviews and communicate the results, problems may exist and go undetected and identified problems may remain uncorrected. Further, if it does not properly monitor the centers, it lacks the information to determine whether the centers are complying with all state and federal regulations contained in their contracts or whether the centers are delivering services as intended by the Office of Small Business. According to the undersecretary of the agency, the agency's goal is to conduct thorough program reviews of each center annually and to revise policies and procedures for the Small Business Development Center Program to reflect that goal.

The Office of Small Business also has not developed a system to ensure that it adequately monitors the centers for compliance with federal audit requirements. Federal regulations require that the centers, as subrecipients of more than $25,000 in federal funds, be audited on a regular basis. If the subrecipient receives less than $100,000 in federal funds, it has the choice of obtaining either a program audit or a single audit. Federal regulations for state and local governments, institutions of higher learning, and nonprofit organizations require subrecipients receiving $100,000 or more in federal funds to obtain a single audit. A single audit is an organizationwide audit of all funds the organization receives. However, the regulations covering institutions of higher learning and nonprofit organizations permit subrecipients receiving funds from only one federal grant to obtain either a single audit or a program audit.

The Office of Small Business is not ensuring that its centers are complying with federal audit requirements.

Federal regulations generally require annual audits except in certain circumstances. For example, biennial audits are permitted for state or local governments who obtained a constitutional or statutory exemption from this requirement by January 1, 1987, or had adopted an administrative policy allowing for less frequent audits for fiscal years beginning before that date. Federal regulations also require the agency, as the primary recipient of the federal funds, to ensure that all subrecipients obtain the appropriate type of audit, which includes the review of the specific federal program that the agency is required to monitor. If the audit notes any instances where the subrecipient did not comply with federal regulations, the agency is also required to ensure that the subrecipient takes appropriate corrective action within six months of receipt of the audit report.

The agency demonstrates some effort at monitoring its subrecipients by contracting with the Department of Finance to complete audits of some of the centers. These audits are to determine the centers' financial compliance with the terms of the contract and to test selected significant internal controls. However, we found that the Office of Small Business has not arranged for audits for seven centers and has not determined whether these centers complied with federal audit requirements since December 31, 1991, a period of five years. For one additional center, the Office of Small Business has not determined whether it complied with audit requirements since the contract first began in fiscal year 1992-93. Furthermore, for another nine centers, the last Department of Finance audits were for periods ending in 1993. Additionally, one other center has not yet been scheduled for an audit of its 1993 funds. Finally, for another center, the Office of Small Business could not tell us when the last audit was conducted.

We observed that the Office of Small Business has not developed written policies and procedures for ensuring that centers obtain audits when required and that the appropriate resolution of any audit issues takes place. According to the director of the Office of Small Business, the agency does not have the staff to review audits of the subrecipients it contracts with and, instead, the agency includes a provision in its contracts with subrecipients that they comply with federal requirements. In addition, she stated that future contract provisions will require that subrecipients include certifications that they have complied with federal audit requirements. This contract provision alone does not release the agency from its responsibility to monitor the subrecipients it contracts with to ensure compliance with all federal audit requirements.

A new contract provision requiring an audit certification will not relieve the agency from its responsibilities to ensure compliance with federal audit mandates.

Because it does not ensure that audits of the centers are conducted with the frequency required by federal regulations and does not have a process to receive, review, and resolve all reported issues, the Office of Small Business is not fulfilling its monitoring responsibility to ensure that the centers are complying with federal audit requirements. Moreover, in the absence of a monitoring process, it is unclear whether the scope and frequency of the audits that are being scheduled fully satisfy the federal requirements. Further, without establishing a system for ensuring that all centers adhere to federal audit requirements, the Office of Small Business reduces its ability to monitor whether the centers are complying with the terms of their respective contracts or if significant weaknesses in the centers' respective internal control structures exist.

Small Business Development Center Program Data Is Not Reliable

Both the State's cooperative agreement with the federal government and the individual contracts with the Small Business Development Center Program's centers require that the centers achieve certain annual benchmarks. These benchmarks are targets for the number of counseling and training sessions the program is to provide, the number of business people that will attend the program's training sessions, and the number of jobs that will be created or retained as a result of the program.

The U.S. Small Business Administration also requires that the Office of Small Business ensure that the centers maintain complete and accurate records and adequate supporting documentation. In addition, the U.S. Small Business Administration requires the Office of Small Business to submit periodic performance reports that include comparisons between the accomplishments achieved by the Small Business Development Center Program and the benchmarks established.

The performance data generated by the agency's automated system are inaccurate.

As discussed in Chapter 1, during our review of the planning efforts of the Office of Small Business for the Small Business Development Center Program, we noted that the results reported for calendar year 1994 far exceeded the benchmarks established. However, according to the director of the Office of Small Business, the information reported by the centers using the automated data processing system produces inaccurate information when summary performance data are compiled by the centers. The Office of Small Business purchased the system from the New York Small Business Development Center Program, and the centers first automated their information reporting in 1993. The director also stated that the long-term solution for the problems is to move the existing database to a new system that will provide the type of management information that the Office of Small Business needs to monitor the centers' performance. In addition, the director stated that beginning with the quarter ending March 31, 1996, the centers will manually calculate selected performance statistics that the system had been double counting until the Office of Small Business can correct the problems and rely on the system.

Each center uses the automated data processing system to report its monthly activities, including those activities targeted in agency contracts. Therefore, this automated system is central to the Office of Small Business's ability, as the lead center, to adequately monitor the performance of the program and intercede when necessary. This has apparently been an ongoing problem. For example, an audit report issued in January 1996 by the Office of the Inspector General for the U.S. Small Business Administration found significant differences when comparing

selected counseling and training statistics reported by the automated system for the 1993 calendar year to the manual information supporting those same statistics. This report recommended that the Office of Small Business manage the Small Business Development Center Program using manual records and reports until the problems with the automated system were corrected. In her response dated November 28, 1995, to that audit finding, the agency secretary stated that the Office of Small Business was well aware that the automated system did not accurately reflect program data, and they were in the process of reviewing alternatives to resolve the problems, such as other software or undertaking the task of developing a new automated program. Further, the secretary stated that the staff of the Office of Small Business lead center had completed an internal comparison of actual 1994 year-end program results to the benchmarks contained in the centers' contracts and felt that, while there were still inaccuracies, closing out open client files had cleared up several of the data discrepancies. However, we could not verify that these data discrepancies had been corrected. Because the Office of Small Business intends to begin manually verifying the information the centers report as of the quarter ended March 31, 1996, we could not evaluate it.

The U.S. Small Business Administration's Inspector General recommended that the agency use manual records and reports until problems with the automated system are corrected.

Because the automated data processing system used by all the centers in the Small Business Development Center Program is not reliable, the Office of Small Business cannot adequately measure the performance of the centers. In addition, the U.S. Small Business Administration cannot adequately measure the effectiveness of the Office of Small Business's performance in its role as the lead center for the Small Business Development Center Program for the same reason. Finally, without having reliable data, the Office of Small Business and the U.S. Small Business Administration could not accurately adjust the benchmarks for the centers to use in the 1995 calendar year. Without accurate measurements of program outcomes, the Office of Small Business does not have the information necessary to properly monitor the program and to assess whether it is performing effectively or efficiently.

The Office of Business Development Needs To Address Certain Issues

The Office of Business Development's mission is to provide assistance to communities in their efforts to stabilize and stimulate their regional and local economies by creating and retaining jobs, increasing the tax base, and creating a more diversified industry base. To accomplish its mission, the Office of Business Development administers nine programs. The Appendix provides

a brief description of these programs. In this section, we discuss problems we noted in the Sudden and Severe program and the Old Growth program.

The Sudden and Severe Program Did Not Comply With Certain Loan Requirements

The Sudden and Severe program is an economic revolving loan fund provided through a partnership between the Economic Development Administration within the U.S. Department of Commerce and the agency. The program is designed to provide start-up and working capital loans to eligible businesses that will stimulate job creation and retention in areas of the state affected by plant and military base closures, defense downsizing, industry layoffs, and presidentially-declared disasters that contribute to job loss in California. According to the program manager, the Sudden and Severe program was inactive from 1989 to 1993. The program became active again in November 1993 under a completely restructured administrative plan.

The program did not document that the loan applicant demonstrated need.

We reviewed one of the six loans that the Sudden and Severe program issued or recommended issuing since the loan program was reactivated in 1993 and found that it did not comply with two requirements. First, the program did not require proper documentation that the loan applicant demonstrated need. The approved administrative plan limits eligibility for program financing to applicants demonstrating need by showing that they were unable to qualify for commercial financing at terms and conditions that would permit completion or the successful operation of the project activities financed. Federal requirements issued by the Economic Development Administration specify that grantees are responsible for obtaining supplemental evidence to support the need for financing. To address this requirement, the program's administrative plan requires that loan applicants provide letters from two banks or lenders detailing their unwillingness to finance the project.

For the loan we reviewed, the applicant attempted to demonstrate need by providing two bank letters denying a loan. However, we found that the bank letters did not demonstrate the ineligibility of the applicant. For example, one bank stated that it did not make the type of equipment loan requested and furthermore, the applicant was not located within its lending area. We believe this letter only demonstrates that the applicant did not go to the appropriate bank, not that he could not obtain the financing if it was available. The second bank denied the loan but provided no written justification for the rejection. Nevertheless, this same bank subsequently provided 79 percent of the nonprogram financing required by the plan to obtain the Sudden and Severe

program loan. The program manager stated that he obtained other information from the banks and concluded that the applicant adequately demonstrated the inability to obtain credit elsewhere, but he did not document the additional information. Further, while the Sudden and Severe program loan review board ultimately approved the loan, it expressed reservations concerning the documentation of the demonstration of need by the applicant. Specifically, the board stated in its minutes that in the future the loan analyst's review narrative should include an assessment of the applicant's inability to obtain credit elsewhere.

The second requirement that the program did not comply with for this loan related to the approved loan term. Specifically, the program manager recommended approval and the loan board approved the loan, which was for equipment, for a 15-year term when the plan regulations for this type of loan only allow a 10-year term. Although the program manager stated that the standard terms normally apply, he believes the board has the authority to modify them under special circumstances. However, the administrative plan states that the standard terms apply except in cases of loan renegotiation. The plan defines loan renegotiation as modifying the terms of existing loans. Because this was a new loan, the standard terms would apply. Finally, although the loan review board approved the loan, we could find no evidence that the program manager or the board discussed this modification or obtained a waiver of the requirement. When the program does not comply with established requirements, the risk increases that it may not be operating as intended.

The loan board approved a 15-year term for an equipment loan when the program's loan regulations only allow for a 10-year term.

Future Monitoring Needs To Be Addressed for the Old Growth Program

The Old Growth program is a new program designed to stimulate the development of rural communities by providing financial and technical assistance to businesses in traditionally resource-dependent areas, such as logging communities, so as to increase employment and foster stronger rural communities. The program went into effect in January 1995. The Office of Business Development administers the program by contracting with three economic development corporations located in resource-dependent rural areas. However, once the term of the economic development corporations' contracts are up, it is unclear how this loan program will be monitored.

The program is conducted in two interrelated phases consisting of grants and loans. The initial phase is funded with a grant obtained from the U.S. Forest Service. The Old Growth program staff work with staff of the economic development corporations to identify projects that would benefit from the loans. The economic development corporations assist borrowers in preparing loan

It is unclear how the Old Growth program will be overseen once the original contracts expire.

applications that are submitted to the Old Growth program staff for credit and eligibility review. Once program staff approve an application, they provide grant funds to the economic development corporations who then lend the funds to approved borrowers. Once a grant has been made, the economic development corporation is responsible for monitoring the loans, collecting payments, and following up on loans in default. As loan principal is repaid, the economic development corporation may reuse the funds to make new loans itself, without the assistance of the Old Growth program staff.

While under contract, the three economic development corporations who administer the Old Growth program are to be monitored by the program manager. Monitoring efforts include the review of quarterly activity and performance reports submitted by the economic development corporations throughout the term of the contract, an annual compliance review of each economic development corporation's loan portfolio and a determination of compliance with the terms of the contract, and review and follow-up, as needed, of each economic development corporation's annual audit report. In addition, each economic development corporation must submit a final report to the Old Growth program manager within 60 days of the expiration date of the contract. The final report must provide a narrative on how the economic development corporation fulfilled the terms of the contract and the specific objectives that have been accomplished.

However, according to the program manager for the Old Growth program, it is her understanding that the agency's involvement in the program ends once the final reports have been submitted by the economic development corporations. The program manager bases her understanding on verbal discussions with and informal memoranda from the U.S. Forest Service. She stated that she has requested a definitive statement on when the agency's responsibility ends, but the U.S. Forest Service has not yet provided it.

We believe there is a continuing need to monitor the program after the expiration of the contracts with the economic development corporations. Specifically, the administrative plan states that as loan repayment occurs, the economic development corporations need to ensure that the reuse of the funds in subsequent loans continues to comply with the U.S. Forest Service Old Growth program requirements for eligible uses. However, without a clear understanding of where the responsibility resides for monitoring the economic development corporations after the contractual relationship with the agency ends, the potential exists for these funds to be used in ways not intended by either the agency or the U.S. Forest Service.

The Office of Strategic Technology Lacks a Process To Receive and Review Audits

The Office of Strategic Technology, located within the Economic Development Division, provides funding, infrastructure, and programs that help to leverage California technology toward the development of new commercially viable products and services. Our review of the agency's compliance with the requirements regarding subrecipients of federal funds included one federal grant administered by the Office of Strategic Technology. Similar to the discussion on the Small Business Development Center Program earlier in this chapter, we found that the agency is not fulfilling its monitoring responsibilities to ensure that subrecipients of federal funds comply with federal audit requirements. Specifically, we found that the Office of Strategic Technology does not have a process in place to receive audits of the subrecipient's federal funds and to review and resolve all reported audit issues. Federal regulations specify that agencies receiving federal financial assistance and providing $25,000 or more to a subrecipient during a fiscal year are required to ensure that the subrecipient complies with federal audit requirements. One of these requirements is that the subrecipient take appropriate corrective action for all instances of noncompliance within six months of receipt of the audit. According to the director, although the Office of Strategic Technology did not receive a copy of the audit, the office was involved with the subrecipient on a regular basis. However, he added that the agency will initiate plans to ensure that federal requirements are more formally met in the future.

The Office of Strategic Technology does not ensure that it receives audit reports; therefore, it cannot review and resolve all reported issues.

Because it does not have a process in place to receive audits of subrecipients' federal funds and to review and resolve all reported audit issues involving these funds, the Office of Strategic Technology is not fulfilling its monitoring responsibility.

The Contracts, Grants, and Loans Office Needs To Strengthen Certain Controls

The Contracts, Grants, and Loans Office within the Administration and Finance Group provides assistance to program staff through contracting in a manner that protects state assets, meets all state contract requirements, ensures uniformity and consistency among the various types of contracts, and provides a separation of duties and an independent review of compliance with contract terms. In addition, the Contracts, Grants, and Loans Office assists in selecting contractors, preparing and executing contracts, and

complying with the regulations and policies relating to contracts. In this section we discuss problems we noted in the agency's controls over contracting.

The Contracts, Grants, and Loans Office Did Not Obtain the Required Approvals Before Goods and Services Were Provided

For the 1994-95 fiscal year, the agency entered into 20 contracts for goods and services totaling $5.8 million, 14 interagency agreements totaling $3 million, and 87 grant agreements totaling $25.6 million providing funds to other public and private entities. We reviewed 5 contracts, 8 interagency agreements, and 9 grant agreements from this fiscal year to see if the agency complied with the more significant requirements of the Public Contract Code, the State Administrative Manual, and the respective grant agreements.

We found that the agency generally complied with state and federal contract and grant requirements. However, we noted two areas of concern. Specifically, we found that work was started on two contracts, four interagency agreements, and five grants before the agreements were approved. In addition, the agency paid for services rendered after the expiration date for one interagency agreement.

The agency generally complied with state and federal contract requirements. However, certain controls did not work as intended.

The Public Contract Code states that all contracts entered into by state agencies are void unless and until approved by the Department of General Services (DGS). However, for two of the five contracts we reviewed, the agency did not obtain the required approvals before the contractor provided goods and services under the contracts. Specifically, the two contractors purchased advertising and provided services totaling approximately $214,500 one month before either the DGS or the agency had approved the contracts.

Further, the State Administrative Manual requires that agencies submit interagency agreements promptly enough to allow sufficient time for the DGS to review and comment prior to the commencement of work. However, in two of eight interagency agreements we reviewed, the agencies who entered into the agreements incurred expenses for up to three months before the agency obtained the required DGS approvals. In addition, for two interagency agreements we reviewed that did not require DGS approval, the contracting departments provided office space and rendered services for up to two months before the agency approved the agreements.

Although goods and services were provided before the approval of the contracts and interagency agreements, the agency did not make any payments to the contractors or agencies until after approval. However, by failing to ensure that approvals are obtained before the work begins, the agency runs the risk that the work performed will not meet with its expectations as outlined in the approved version of the agreement.

Similarly, in five of the nine grant agreements we reviewed, the grantees commenced work up to four months before the agency approved the agreement. Although grant agreements are not subject to the Public Contract Code, requiring that they be approved before the grantee begins to provide services is an important control to ensure that the grantee is conducting operations in the manner that the agency intends.

Finally, we noted one case where the agency received and paid for services rendered in October and November 1995, the two months following the expiration date of the interagency agreement. Specifically, in November 1995 and January 1996, the entity that entered into the interagency agreement with the agency submitted invoices totaling $39,069. The invoices represented services rendered from July 1, 1995, through November 30, 1995. However, the term of the interagency agreement ended on September 30, 1995. Therefore, part of the invoiced amounts were for services rendered in October and November 1995, two months after the expiration of the interagency agreement. In December 1995, the agency prepared an amendment that was approved on January 29, 1996, extending the term of the interagency agreement.

The agency developed formal procedures that should strengthen its controls over contracting requirements.

After we discussed these issues with staff, the agency developed formal procedures in February and March 1996 that, if followed, should strengthen its controls in these areas.

Conclusion

The agency needs to improve its administrative and operational controls in certain areas. Specifically, the Office of Small Business has not provided guidance in the form of approved and updated policies and procedures to the corporations that administer its Loan Guarantee Program. As a result, the corporations may be interpreting the law and their own unapproved credit policies in ways not intended by the Office of Small Business. Furthermore, the Office of Small Business has not adequately monitored the Loan Guarantee Program and did not fulfill its monitoring responsibilities for the Small Business Development Center Program. Moreover, the Office of Small Business has not ensured that the performance data it receives for its Small Business Development Center Program is accurate.

When it does not fulfill its monitoring responsibilities and does not ensure it receives accurate performance data, the Office of Small Business cannot effectively measure the programs it administers.

We also found that the agency's Office of Business Development did not ensure that it complied with two of the loan requirements for the Sudden and Severe program and has not addressed the future monitoring responsibilities for the Old Growth program.

Furthermore, the agency's Office of Strategic Technology did not have a monitoring process in place to receive audits of the subrecipients it oversees that includes reviewing and resolving all reported audit issues involving federal funds, and as a result is not fulfilling its monitoring responsibilities.

Finally, the administrative controls designed by the agency's Contracts, Grants, and Loans Office to prevent work from starting before the applicable contract, interagency agreement, or grant agreement is approved and to prevent paying for services rendered after the expiration date of an agreement did not function as intended. When these controls fail, the work performed or paid for may not be what the agency intended as stated in the approved agreement.

Chapter 3

Possible Streamlining Opportunities Available to the Trade and Commerce Agency

Chapter Summary

The Trade and Commerce Agency (agency) administers a large number of highly diverse programs and offices. Three deputy secretaries report to the secretary and the undersecretary of the agency on the operations of 22 offices and 17 programs (see the Appendix for the agency's organization chart and a brief description of each of the programs it administers). One of the major tenets in the agency's business philosophy is to provide for the unmet needs of business by optimizing the use of its scarce resources. However, we found certain instances where the agency may not be fulfilling its mission in the most effective and efficient manner. Specifically, one of the agency's programs could better focus its efforts on unmet needs, another program appears unsuited to the agency's mission, and several programs in one division appear to duplicate efforts.

Because the agency is responsible for so many programs, it has found it necessary to keep resource allocations to an absolute minimum to staff its many activities while maintaining the diversity of its programs. Therefore, it is critical that the agency maximize its resource flexibility. The more the agency focuses on unmet needs, takes on only programs central to its mission, and eliminates duplication of efforts, the more successful it will be in stretching already scarce resources and maintaining its flexibility in using those resources.

The California Economic Development Financing Authority Could Better Focus Its Efforts on Unmet Needs

The California Economic Development Financing Authority (Financing Authority) was created in 1995 to finance public and private development projects through various methods including direct loans to businesses and industrial development bonds. The program is currently active only in marketing and providing industrial development bonds.

The Office of Business Development established the Financing Authority's mission to support local economic development by addressing financing needs not currently met by local, federal, or other state financing programs. The authority of local governments to issue industrial development bonds expired on December 31, 1994. The Financing Authority began issuing bonds to fill the void.

Despite legislation reinstating the authority of local governments to issue industrial development bonds, the Financing Authority continues to solicit and process applications for these bonds.

Despite legislation which became effective in May 1995 reinstating the authority of local governments to issue industrial development bonds until January 1, 1999, the Financing Authority continues to solicit and process applications for these bonds. The Financing Authority has been involved with seven projects that have been approved for financing but not yet funded since local governments have again been able to issue industrial development bonds.

The agency secretary stated that the Financing Authority provides a lower-cost, less restrictive alternative to local government bond financing. For example, she stated that borrowers do not have to comply with the prevailing wage as is necessary with local government bond financing. For borrowers in jurisdictions without local government bond financing, she believes the Financing Authority is more cost-effective than private organizations because they must use the community as the bond issuer, generally resulting in higher fees. The secretary also stated that rather than creating duplication among industrial development bond programs, the net effect is lowering the cost of industrial development financing for small- and medium-sized businesses by providing choices in the industrial development bond market.

We did not audit these private organizations to determine whether they were more or less cost-effective than the Financing Authority bond services, but borrowers could and did obtain industrial development bond financing from local providers prior to the entry of the Financing Authority into the bond issuance arena.

In addition, the senior development specialist in charge of the Local Development Unit that oversees the Financing Authority stated that the program helped fill a void that exists in areas lacking financing authorities. He further stated that all the projects that the Financing Authority had approved for financing since the authority for local governments to issue these bonds themselves was reinstated have been in communities that are not active industrial development bond issuers.

We asked the agency to provide us with documentation that the communities where the Financing Authority had approved financing projects were not active issuers of industrial development bonds. However, it was not able to provide this evidence, indicating that this information was obtained verbally.

The communities where the Financing Authority has approved financing projects are in Orange, Los Angeles, Riverside, and Stanislaus counties, and the City of Turlock.

Although the Office of Business Development only dedicates one full-time position to the Financing Authority, its efforts are now being directed exclusively toward providing for financing needs that can be met by local governments. Therefore, the Financing Authority may be failing to identify and provide for needs not currently being met by other financing programs.

The Dry Cleaning Plant Registration Program Should Be Transferred or Discontinued

The Office of Small Business administers the Dry Cleaning Plant Registration Program (dry cleaning program). The purpose of this program is to maintain a complete informational database to effectively identify and register all dry cleaning plants in the State. The registration and biennial renewal fees are intended to cover the actual cost of developing and maintaining a registration list, as well as promoting environmental and business loan programs and technical assistance programs related to the dry cleaning industry. The program also ensures that dry cleaning businesses maintain surety bonds to cover any damage to garments left in their care, but the program has no involvement with mediating consumer complaints concerning the industry. The 1995-96 fiscal year budget for the dry cleaning program was approximately $100,400.

The agency agrees that the dry cleaning program has no connection with stimulating economic development or creating and retaining jobs in California.

Because the dry cleaning program is regulatory in nature and not connected with stimulating economic development and creating and retaining jobs, we believe that it should be transferred to the Department of Consumer Affairs if it is deemed necessary, and if not, it should be discontinued. The secretary of the agency agrees with our assessment of this program and has submitted a legislative proposal to discontinue it.

Six of the Agency's Direct Loan Programs Appear To Duplicate Efforts

Currently, the Economic Development Division has six different direct loan programs. Three of these programs are administered by the Office of Small Business and three are administered by the Office of Business Development. Each of the six loan programs has its own loan officer who reportedly spends between 20 and 50 percent of the time reviewing and making recommendations regarding loan applications. As all the direct loan programs have

minimal staff, typically one to three, having a loan officer dedicated to each program may not be the optimal use of the scarce resources available to these programs.

The agency secretary told us that the loan programs serve such dissimilar clients that each program requires the dedicated expertise of its own loan officer. She believes that trying to consolidate loan officer activities and expertise between the two offices would be inefficient. The secretary likened such a consolidation to a bank combining its commercial real estate development lending activities with its residential mortgage program, stating that the expertise required for each activity is incompatible. However, we still question whether the current structure is the most cost-effective option. While it is true that each loan program serves a different client base—local governments, rural wood product industries, and businesses in economically depressed areas in the Office of Business Development programs; small business owners of underground storage tanks, small business hazardous waste generators, and low-income fishing fleet operators in the Office of Small Business programs—the process for granting a loan for five of the six programs is very similar, and the final result is that the business must show credit worthiness.

We question whether the current structure of dedicating one loan officer to each of the agency's six direct loan programs is the most cost-effective option because certain loan functions may be similar enough to consolidate.

While the criteria may vary from program to program, the analysis of credit worthiness is similar. For example, if a wood chip manufacturer seeks a loan from the Old Growth Diversification Revolving Loan Fund program, the manufacturer must demonstrate to the program's satisfaction that it has the ability to create jobs, service the debt, and remain in business. Similarly, if an irrigation equipment manufacturer seeks equipment financing from the Sudden and Severe Economic Dislocation Revolving Loan Program, it must document to the program's satisfaction that it has the ability to create jobs, service the debt, and remain in business.

For the sixth program, the Rural Economic Development Infrastructure Program (REDIP), we acknowledge that the program's loan officer, as a lender to local governments, may require some specialized knowledge of local government financing. However, even in the REDIP, we believe there are certain functions that may be similar enough to warrant consideration as to how they could be consolidated or reengineered.

Conclusion

During our review, we noted there were possible streamlining opportunities available to the agency. The Financing Authority is currently active only in the marketing and issuing of industrial development bonds, duplicating services available from local providers.

Also, the agency administers a registration program for dry cleaning plant operators that has no connection with its mission and should be either transferred or discontinued.

Finally, the agency's six direct loan programs appear to be duplicating efforts with separate loan officers. Loan officer duties could be either consolidated or otherwise reengineered to reduce the amount of overlap in reviewing and approving loans.

Chapter 4

The Trade and Commerce Agency Did Not Meet All Its Statutory Reporting Requirements

Chapter Summary

Statutes required the Trade and Commerce Agency (agency) to submit 21 reports to the governor and the Legislature for fiscal year 1994-95 activity. However, the agency did not prepare 4 of the 21 required reports. Further, the agency submitted 2 reports that did not address all the topics required and submitted an additional 4 reports after the date required in the statutes. The agency submitted the remaining 11 reports on time and all 11 reports addressed the statutorily required topics.

The Agency's Statutory Reporting Responsibilities

The agency prepared 11 of 21 required reports in accordance with statute.

The Government Code and the Corporations Code required the agency to report on a variety of topics relating to fiscal year 1994-95. The topics of the reports ranged from a strategic plan for defense conversion and training programs to a tourism marketing plan for the State. Of the 21 required reports, the agency prepared 11 in accordance with the statutes. However, for the remaining 10 reports, the agency either did not prepare the report, did not address all required topics, or did not submit the report by the date required. Table 2 presents a description of each of the required reports as well as the results of our review.

The Agency Did Not Prepare All Required Reports

The agency did not prepare 4 of the 21 reports required by the statutes. Specifically, the Government Code, Section 15355.3, requires the agency to report on its industrial marketing program, which includes information regarding its response to corporations inquiring about industrial sites in California. The agency did not prepare this report because the undersecretary believed the law requiring the report was repealed.

Table 2

Trade and Commerce Agency Statutorily Required Reports for Fiscal Year 1994-95 Activity

	Agency Office Responsible for Report	Statute Requiring Report	Report Description	Reports the Agency Did Not Prepare	Reports Submitted on Time but Lacking Some Required Topics	Complete Reports Submitted Late	Complete Reports Submitted on Time
1.	Agency Secretary	Government Code 15363.6(c)	The policies, plans, budgeting, and accomplishments of the agency and its programs.				X[a]
2.	Agency Secretary	Government Code 15355.3	Report on the agency's industrial marketing program.	X			
3.	California Council To Promote Business Ownership by Women	Government Code 15365.41	The status of women-owned businesses within the State.				X
4.	California Council To Promote Business Ownership by Women	Government Code 15365.42	The council's recommendations regarding women-owned businesses.		X		
5.	Agency Secretary	Government Code 15363.10(f)	An interim report from the Agency Secretary regarding the California Economic Development Strategy Panel's statement of what will be addressed in the final recommendation of the panel.			X	
6.	Agency Secretary	Government Code 15363.10(d)	The California economic development strategic plan.			X	
7.	California Export Finance Board	Government Code 15394.1	Critique of the finance board's program, its needs, and recommended changes.				X
8.	Film Office	Government Code 15378(c)	The time periods for the permits issued; the median, minimum, and maximum times for processing permits; and a description of the appeal process.	X			
9.	California Main Street Program	Government Code 15399.8	The effectiveness of the Main Street program.				X
10.	Defense Conversion Council	Government Code 15346.5(a)	A strategic plan for federal, state, and local defense conversion and training programs. The plan addresses the State's role in assisting communities impacted by base closures.				X
11.	Defense Conversion Council	Government Code 15346.5(l)	An evaluation of the impact of the State's matching fund expenditures on the California economy. The report considers job growth, increased state and local revenues, and any other factors for measuring the effectiveness of the program.				X
12.	Division of Tourism	Government Code 15364.52	A tourism marketing plan for the State of California.				X

	Agency Office Responsible for Report	Statute Requiring Report	Report Description	Reports the Agency Did Not Prepare	Reports Submitted on Time but Lacking Some Required Topics	Complete Reports Submitted Late	Complete Reports Submitted on Time
13.	Division of Tourism	Government Code 15364.54	An assessment of the overall benefits and effectiveness of the tourism marketing and advertising program.		X		
14.	Office of Permit Assistance	Government Code 15399.51(b)(2)	An evaluation of the extent to which establishing the office has resulted in an expedited development permit process.	X			
15.	Office of Small Business	Corporations Code 14030.2(b)	The loss experience for the expansion fund for loan and surety bond guarantees.			X	
16.	Office of Small Business	Corporations Code 14037.7	The number of small business disaster loan guarantees approved and rejected by gender, ethnic group, type of business and location, and each participating loan institution.				X
17.	Agency Secretary	Corporations Code 14076(a)	The financial status of the small business development corporations and their portfolios of loans and surety bonds guaranteed.				X
18.	Agency Secretary	Government Code 15331.2	A statistical abstract of pertinent information regarding the numbers of small businesses, demographics, minority and women-owned businesses, net income, payroll, employee benefits, funding sources, size classification, and any other information deemed necessary by the agency.				X
19.	San Diego Regional Office[b]	Government Code 15323.5	Recommendations on methods, programs, and policies to improve growth of jobs, income, and standards of living along the border.				X
20.	World Trade Commission	Government Code 15364.7	A description of the commission's activities, information and data on relevant trade patterns and trends, analysis of major trade issues, and an action agenda for the next two years.			X	
21.	World Trade Commission	Government Code 15364.25	A description of the Global Applied Technology Service's activities and recommendations.	X			
			Totals	**4**	**2**	**4**	**11**

[a] The agency fulfills the requirement for this report by issuing the following reports: Governor's Budget Summary, International Trade and Investment Year in Review, Division of Tourism Annual Report, 1995 Business Initiatives, Record of the Trade and Commerce Agency, California Main Street Annual Report, and TeamCalifornia Annual Report.

[b] The agency's Office of California-Mexico Affairs addressed this requirement in its 1995 Year in Review report.

In addition, the Government Code, Section 15399.51(b)(2), requires the Office of Permit Assistance (office) to submit by January 1, 1996, a report evaluating the extent to which the office has achieved an expedited development permit process. The office director stated that his office was understaffed during the two prior fiscal years and was never able to initiate the report. He anticipates that work on this report will begin within the next six months.

Also, statutes created the California State World Trade Commission (commission) within the agency to address policies that affect California's ability to trade internationally and to develop and implement effective and aggressive marketing strategies. The commission is required by the Government Code, Section 15364.25, to report on its activities and recommendations relating to the Global Applied Technology Extension Service (GATES). The GATES was enacted in 1990 with a focus of promoting rapid global commercialization of California products and technologies. Although the statutes requiring the GATES expired January 1, 1996, the agency was still required to report on the program during fiscal year 1994-95. The undersecretary stated that the agency did not report on this program because statutes requiring GATES were passed without an appropriation. As a result, the commission had insufficient funding and did not implement it. Thus, there was nothing to report on.

Finally, the Government Code, Section 15378(c), (Permit Reform Act) requires all state agencies who issue permits to annually report on the time periods for processing and approving permits, a description of the appeals process, and the number of appeals. The Government Code, Section 14998.8, designates the Film Office as the permitting authority for the use of state-owned property and state employees' services for the purpose of making commercial motion pictures. Despite the Film Office's designation as the permitting authority with respect to commercial motion pictures, it does not issue any reports pursuant to the Permit Reform Act. The agency's undersecretary stated that he believes the Permit Reform Act does not apply to the Film Office because it issues licenses to use state property and not permits as envisioned by the Permit Reform Act. However, based upon our review of the act, which defines a permit as any license, certificate, registration, permit, or any other form of authorization required by a state agency to engage in a particular activity or act, we could not conclude that a report was not required.

Agency Reports Did Not Address All Required Topics

The agency submitted two reports that did not address all topics required by the statutes. Specifically, the Government Code, Section 15364.54(c), requires the agency's Division of Tourism (division) to document the directly attributable benefits of its marketing program to California's tourism industry, including employment in California, state and local tax revenues, and the State's lesser-known and underutilized destinations. The agency did not include in its 1994 report the directly attributable benefits of all the programs contained within the marketing program. Specifically, the agency only reported on the benefits of the marketing program's advertising and fulfillment programs. The advertising program is a composite of numerous advertising strategies, including television commercials and magazine advertisements. The fulfillment program is a promotional effort consisting of responding to requests for tourist information as well as production of this promotional literature. Together, the budgets for these programs comprise approximately 67 percent of the marketing program's total budget.

The division's director stated he focused on the benefits directly attributable to the advertising and fulfillment programs because he does not believe it is possible to measure the benefits of the other programs to the elements required in the statutes. He also stated that the division does use other methods to measure these programs. For example, the division's staff meets with travel writers and editors regularly to encourage development of stories about California travel destinations. Further, the director stated that the division determines how many stories it influenced and the advertising equivalency value of these stories. However, he believes that since the actual tourism sale is too far removed from the division's efforts, the division cannot determine the benefits directly attributable to this program for California's tourism industry, employment in California, state and local tax revenues, and the State's lesser-known and underutilized destinations. After we discussed this with the division's director, the division took steps to rectify the situation by recommending that the statute be amended to clarify the reporting requirements.

Additionally, when the division documented the benefits directly attributable to the advertisement and fulfillment programs, it did not include those benefits to employment in California and local tax revenues. The director stated that the division did not include benefits to these elements because it concentrated its efforts on producing credible estimates of return on investment and inadvertently omitted efforts to determine the benefits to these elements. This same statute requires that the agency establish standardized and accurate methods to annually measure California's share of the domestic and international tourism

markets and include this information in each report. The division's director stated that the division did not include these methods in the 1994 annual report because it reported this information in the 1992 annual report.

We also noted one additional instance where the agency's reports did not address all the topics required by the statutes. The report prepared by the California Council To Promote Business Ownership by Women (council) did not include detailed multiyear plans of action as required by the Government Code, Section 15365.42. The agency's secretary, who is a council member, stated that the council was unable to obtain the necessary data to prepare this information because of insufficient funding.

The Agency Did Not Always Submit Reports on Time

The agency submitted 4 of the 21 reports required after the respective report's statutorily mandated deadline. One report was 13 months late, and 2 reports were 2 months late. A fourth report was in draft stage as of the end of March 1996, 3 months after the deadline.

Conclusion

The agency prepared 11 of 21 reports required by statute for fiscal year 1994-95 in accordance with the statutes. However, the agency did not prepare 4 other statutorily required reports. The agency also submitted 2 reports that did not address all the topics required. The agency does not believe that it is possible to provide all the information required by the statute for one of these reports. Finally, the agency submitted an additional 4 reports after the date required in the statutes.

Chapter 5

Recommendations

The Trade and Commerce Agency (agency) has expended substantial efforts to plan for its respective offices and programs and to demonstrate the benefits achieved. All of the offices and programs that we reviewed addressed, in various ways, what they were trying to do and how they planned to do it. However, our review of the agency's efforts revealed that while much has been done, more complete and consistent efforts are needed.

To ensure that the diverse programs and activities administered by the agency demonstrate their worth and perform at their optimal level of efficiency and effectiveness, the agency needs to take the following actions:

- Provide guidance to the management team responsible for planning on how to develop an integrated approach that will yield high-quality, consistent management information;

- Develop plans that include all the fundamental elements, including establishing goals and objectives supporting a well-defined mission, defining performance measures and setting challenging benchmarks for expected outcomes or benefits linked to all appropriate objectives, measuring the results of planned operations against the benchmarks to evaluate performance, and resetting benchmarks where necessary;

- Use the management information supplied from such an integrated planning approach to optimize its allocation of resources and develop its annual budget;

- Develop a consistent method to follow up and document client-supplied information and consider verifying some of the inherently less reliable client-supplied information on a sample basis; and

- Use the follow-up information to refine the results reported to management, the Legislature, and others interested in the agency's activities.

To ensure that the agency's offices and programs are functioning as intended, management needs to improve its administrative and operational controls by ensuring that:

- The Office of Small Business develops formal policies and procedures so the corporations that administer the agency's Loan Guarantee Program have specific guidance to follow regarding the office's interpretations of the laws governing the program and that the corporations are administering it in the way the Office of Small Business intends, establishes a process to ensure completion of its monitoring responsibilities for the Small Business Development Center Program and develops a process to ensure that it receives accurate performance information for the program;

- The Office of Business Development complies with requirements of the Sudden and Severe Economic Dislocation Revolving Loan Program established to ensure that the program operates as intended, addresses future monitoring responsibilities for the Old Growth Diversification Revolving Loan Fund program as they relate to oversight of the economic development corporations by continuing to work with the U.S. Forest Service to obtain guidance concerning monitoring responsibilities once the economic development corporations become independent sources of loan funds;

- The Office of Strategic Technology fulfills its monitoring responsibilities to ensure that subrecipients comply with federal audit requirements by developing a process to receive, review, and resolve all reported issues involving federal funds. Additionally, the agency should ensure that it has appropriate monitoring processes for all of its offices that have subrecipients; and

- The Contracts, Grants, and Loans Office obtains approvals before work begins on contracts, interagency agreements, and grants, and that it does not pay for services rendered after contracts expire.

To take advantage of the streamlining opportunities available to it, the agency should take the following actions:

- The California Economic Development Financing Authority should refocus its efforts toward identifying needs not currently being met by other financing sources;

- Continue its efforts to divest itself of the Dry Cleaning Plant Registration Program; and

- Reengineer or consolidate the overlapping duties of loan officers relating to reviewing and approving loans.

To meet all its statutory reporting requirements, the agency should ensure that:

- All statutorily required reports are submitted by the due date and include all the topics required by statutes. In addition, if the agency believes that current reporting requirements are inappropriate, it should request that the statutes be modified.

We conducted this review under the authority vested in the state auditor by Section 8543 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,

KURT R. SJOBERG
State Auditor

Date: April 24, 1996

Staff: Karen L. McKenna, CPA, Audit Principal
Doug Cordiner
Tammy Bowles, CPA
Rebecca Blair
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Appendix

Description of Programs and Activities Administered by the Trade and Commerce Agency

During the period covered by our review, the Trade and Commerce Agency (agency) administered various programs and activities. The organization chart in Figure 1 depicts the agency's programs and offices and its staffing levels for each. A description of the programs and activities is provided below.

Economic Development Division

The **Regional Field Offices** located in Sacramento, San Jose, Los Angeles, and San Diego provide services to businesses including one-on-one problem solving, expansion assistance, attraction efforts, and employment and training for companies interested in locating in California.

The **Office of Major Corporate Projects** helps large companies promote business opportunities in California through advocacy of policy issues that affect corporate business, tax incentives, worker compensation, and permit assistance.

The **Office of Permit Assistance** provides confidential counseling and access to regulatory data to the private sector and local governments to improve environmental and permit assistance.

The **Office of Small Business** administers the Small Business Development Center Program, the Dry Cleaning Plant Registration Program, two loan guarantee programs, and three direct loan programs.

- The **Small Business Development Center Program,** executed through agreements with 27 small business development centers, provides business counseling, referrals, and training activities to small businesses in California counties. In some instances, the centers also provide assistance in areas of technology transfer, international expansion, and government procurement.

- The **Dry Cleaning Plant Registration Program** maintains a complete informational database to identify and register every dry cleaning plant in California.

- The two loan guarantee programs, executed through contracts with eight small business development corporations, are the **Loan Guarantee Program** and the **Disaster Loan Guarantee Program.** The Loan Guarantee Program provides loan guarantees to local lenders for loans made to small businesses that are unable to find conventional funding and bond guarantees to corporate sureties for bonding small businesses. The Disaster Loan Guarantee Program provides loan guarantees to lenders for loans made to small businesses affected by a disaster who are waiting to receive long-term financing from the U.S. Small Business Administration and for loans made to farmers affected by a disaster.

- The three direct loan programs administered by the Office of Small Business include the **Repair of Underground Storage Tank Loan Program,** the **Hazardous Waste Reduction Loan Program,** and the **Fishing Fleet Energy Retrofit Loan Program.** The Repair of Underground Storage Tank Program provides loans to small business owners and operators of petroleum underground storage tanks who cannot find financing elsewhere for tank removal, replacement, or upgrading. The Hazardous Waste Reduction Loan Program provides loans to small businesses that are certified hazardous waste generators so they can purchase and install equipment that will reduce the amount of hazardous waste they generate. The Fishing Fleet Energy Retrofit Loan Program provides loans to low-income commercial fishing fleet operators who cannot find financing elsewhere for boat improvements that will reduce their energy costs and conserve fuel.

The **Office of Business Development** provides nine programs and services designed to assist local governments in their business retention, expansion, and attraction efforts. The Office of Business Development administers its programs through three units: the Local Development Unit, the Enterprise Zone Unit, and the Defense Conversion Unit.

- The **Local Development Unit** administers seven programs including:

  The **Old Growth Diversification Revolving Loan Fund** program provides grants to local economic development corporations that, in turn, make loans to facilitate the development of rural economies through financial and technical assistance to businesses in traditionally resource-dependent communities.

The **Sudden and Severe Economic Dislocation Revolving Loan Program** provides start-up and working capital loans to businesses leading to the creation and retention of jobs in areas of the State affected by plant and military base closures, defense downsizing, industry layoffs, and presidentially-declared disasters that have contributed to job loss in California.

The **Rural Economic Development Infrastructure Program** provides loans to rural local governments for the construction, rehabilitation, or acquisition of certain types of infrastructure, such as sewer and water facilities. In 1993, the program exhausted the balance of its legislative funding and was dormant until November 1994 when the loan portfolio was used as collateral for a financing bond issued by the Rural Economic Development Infrastructure Panel that provided new funding for the loan program.

The **California Economic Development Financing Authority** provides financing for public and private development projects through various methods including industrial development bonds and revolving loan funds.

The **California Main Street** program provides technical assistance and training for revitalization of downtown and neighborhood commercial business districts based on a national four-point model that focuses on organization, promotion, design, and economic restructuring.

The **TeamCalifornia** program provides administrative support to TeamCalifornia, which is a volunteer statewide network of economic development professionals established to coordinate economic development activities for business attraction, retention, and expansion projects. The TeamCalifornia support unit provides support functions such as planning and attending trade shows, preparing and distributing the TeamCalifornia newsletter, and coordinating requests for TeamCalifornia advisory services.

The **Public Finance Program** provides internal support to the Office of Business Development by developing proposals to federal agencies for economic development program funding. In addition, the program provides information to the public on federal funding programs for economic development.

- The **Enterprise Zone Program** provides special incentives such as tax credits for sales and use taxes, hiring credits for wages paid to qualified employees, and 15-year carryover of net operating losses to stimulate business and industrial growth in depressed areas. In addition, businesses located within enterprise zones may receive local incentives such as waivers or reduction of fees, streamlined review of permits, reduced land costs, and low-cost financing.

- The **Defense Conversion Program** provides assistance to communities and businesses by identifying matching funds for federal grants to be used for state defense industry conversion and base closure and reuse projects to shift people, skills, technology, equipment, and facilities currently in national defense into alternative economic endeavors.

The **Film Office** provides programs to assist film production, post production, and related industries. Film production is facilitated through a one-stop permit center for all state property, location assistance, and problem solving. In addition, the office acts as the central point of coordination with federal, state, and local agencies to simplify the permitting process.

The **Office of Strategic Technology** provides funding, infrastructure, and programs to help leverage California technology into the development of new commercially-viable products and services.

International Trade and Investment Division

The **Office of Foreign Investment** provides potential investors with locations and availability of appropriate plant sites or office facilities, labor availability, and permit assistance. In addition, the office schedules foreign investment missions linked to industry trade shows and symposia to introduce executives of foreign companies to strategic alliance opportunities such as equity investment, joint ventures, and licensing agreements.

The **Office of Export Finance** provides working capital loan guarantees to help qualified companies acquire short-term working capital loans to complete specific export sales.

The **Office of Export Development** promotes exports through trade show participation focused on high-value products with strong export potential as well as trade leads.

The **International Field Offices** located in Hong Kong, Japan, the United Kingdom, Germany, Mexico, Taiwan, Israel, and South Africa provide in-country coordination and support for the agency's trade shows, investment promotions, and business missions, as well as direct assistance to California companies seeking business opportunities.

The **Office of California-Mexico Affairs** serves as a liaison between California and the Mexican states bordering the United States to further favorable economic, educational, and cultural relations. In addition, the office provides assistance on issues involving the North American Free Trade Agreement.

Division of Tourism

The **Division of Tourism** promotes travel to and within the State through national and international advertising; state-organized travel trade sales missions; heightened California presence at major travel trade shows; tourism development representatives in Japan, the United Kingdom, Germany, and Mexico; cooperative marketing campaigns and promotions; publicity, press trips, and media relations; production of California visitor guides, maps, travel trade guides, regional brochures, and other printed matter; and toll-free telephone visitor information.

The agency also receives support services from the following groups and offices:

Administration and Finance Group

The **Office of Administrative Services** provides administrative support services to the agency's programs and activities through fiscal direction and oversight, budget planning and execution, and accounting for the agency's revenues and expenditures. This office also provides personnel services including payroll, labor relations, and training; business services including procurement, inventory management, and record retention; and data processing direction and planning.

The **Contracts, Grants, and Loans Office** provides assistance to program staff through contracting in a manner that protects state assets, meets all state contract requirements, ensures uniformity and consistency among the various types of contracts, and provides a separation of duties and an independent review of compliance with contract terms. In addition, the Contracts, Grants, and Loans Office assists in the contractor selection process, contract preparation and execution, and compliance with regulations and policies relating to contracts.

Office of Marketing and Communications

The **Office of Marketing and Communications** serves as a liaison between the agency and all state, national, and international news organizations. The office also oversees the marketing fund for all communication projects and the marketing contracts for economic development. Finally, it manages, coordinates, and responds to general inquiries and Governor's Office correspondence and develops issue memoranda on behalf of the agency.

Policy and Planning Group

The **Office of Economic Research** provides technical research services to support the agency's programs, participates in the major initiatives of the agency, prepares publications to support the work of the agency's economic development programs and in response to legislative mandates, and provides consulting services and research to agency staff and individuals outside the agency. This office also oversees the activities of the Regulation Review Unit responsible for evaluating the economic impacts, reporting requirements, and providing alternative analysis of any state agency that proposes to adopt regulations.

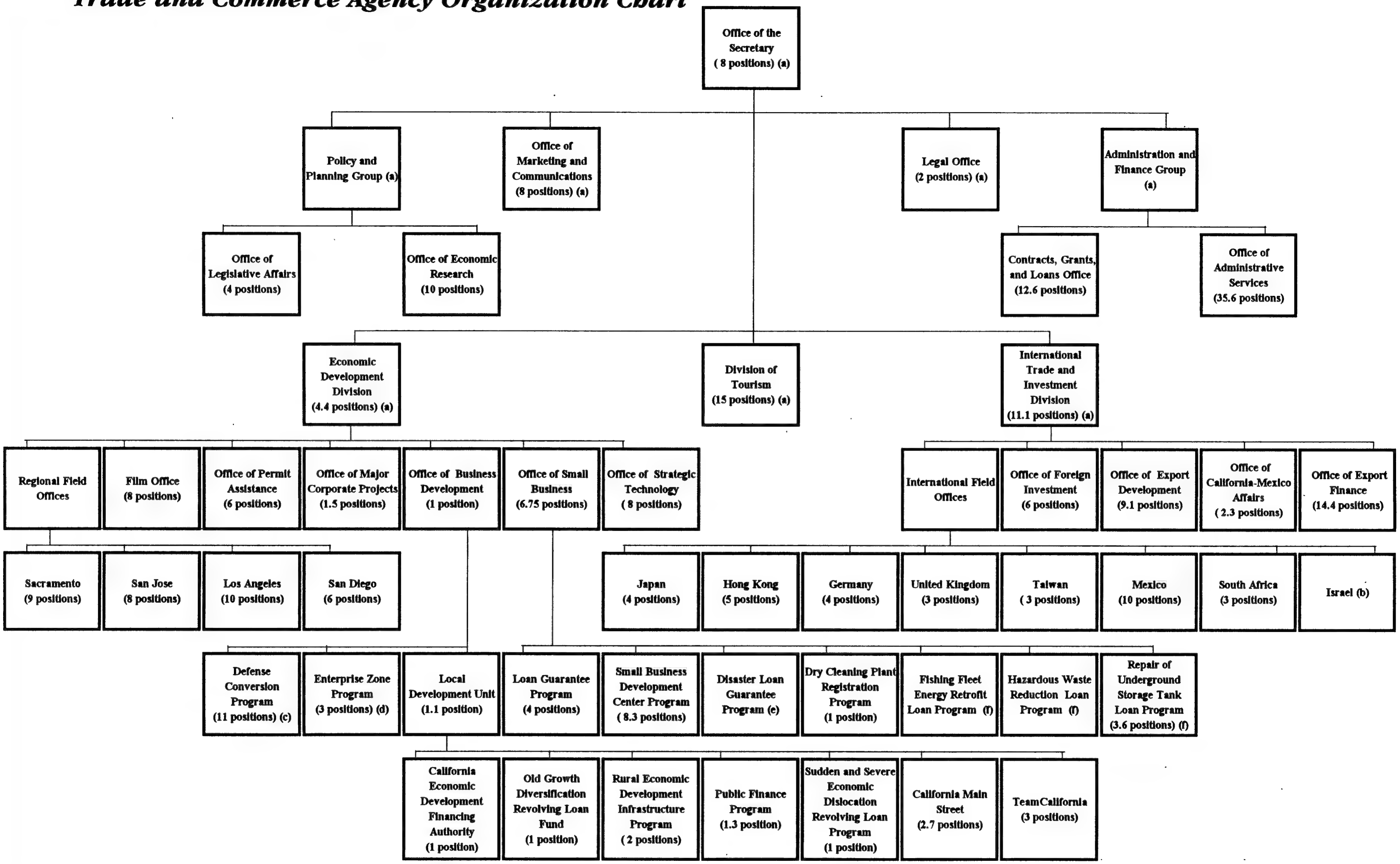
The **Office of Legislative Affairs** serves as a liaison between the agency and the Legislature through the initiation and monitoring of all legislation that relates to economic development, small business, technology, taxation, foreign trade and export, tourism, and any other issues that impact the State's business climate.

Legal Office

The **Legal Office** serves as counsel to the management of the agency providing legal interpretations, contract review, and legal advice on all legislation and local ordinances and regulations that impact the State's economic development.

Figure 1

Trade and Commerce Agency Organization Chart



(a) The positions shown above are actual. Table 3 is a comparison of actual positions to the positions authorized by the budget.

(b) The Israel office is operated under a contract.

(c) The Defense Conversion Program administers the following functions: Community Assistance/State Defense Conversion Plan Implentation/and Base Re-use Marketing, the Defense Adjustment Grant, and the California Ecnomic Diversification and Revitalization Clearinghouse.

(d) The Enterprise Zone Program administers the following functions: the Los Angeles Revitalization Zone and the Local Area Military Base Recovery Act .

(e) Staff in the Loan Guarantee Program also administer the Disaster Loan Guarantee Program.

(f) Staff in the Repair of Underground Storage Tank Loan Program also administer the Fishing Fleet Energy Retrofit and Hazardous Waste Reduction loan programs.

(g) There are various boards and commissions affiliated with the agency. Among these boards and commissions are the Small Business Development Board and the World Trade Commission discussed in this report.

Table 3

Comparison of Actual Positions at the Trade and Commerce Agency to Positions Authorized by the Governor's Budget

	Actual Positions	Positions Authorized
Office of the Secretary	8.00	10.0
Policy and Planning Group	14.00	15.0
Office of Marketing and Communications	8.00	8.0
Legal Office	2.00	2.0
Administration and Finance Group	48.20	51.4
Economic Development Division	112.65	122.0
Division of Tourism	15.00	16.0
International Trade and Investment Division	74.90	86.0
Totals	**282.75**	**310.4**

CALIFORNIA TRADE AND COMMERCE AGENCY

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Pete Wilson
Governor

Julie Meier Wright
Secretary

April 17, 1996

Kurt R. Sjoberg, State Auditor
Bureau of State Audits
660 J Street, Suite 300
Sacramento, California 95814

Dear Mr. Sjoberg:

Thank you for the opportunity to respond to the California State Auditor's performance audit of the Trade and Commerce Agency. My agency sincerely appreciates the professional manner in which your staff conducted this audit, including their willingness to learn as much as possible about our extensive and diverse operations. I commend you and your staff for reflecting a comprehensive understanding of our economic development and marketing activities in the audit report. Your perspective from "the outside" has provided us with sound advice on how to re-think our planning and assessment processes.

As we have discussed from the beginning, the Trade and Commerce Agency, though relatively small, has undertaken a multitude of diverse activities largely reflective of the diverse needs of California's businesses. Not only have we tried to be responsive to specific needs, we also seek to lead efforts to preserve California's economic base and grow it successfully. We recognize that the interdependence of our various programs resembles the interdependence of sectors of the economy. We appreciate your acknowledgment that, despite our not following a formal, highly integrated strategic planning process internally, we have successfully integrated our efforts externally, such as with the Economic Strategy Panel and TeamCalifornia.

I could not agree more with your general assessment of our agency, as reflected in your report: you recognize that we have been successful in many of our efforts, that we have developed new and creative approaches to working with California businesses considering moving out of state, and that we continue to grow effective public-private partnerships in areas of economic development, international trade, and tourism.

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We generally concur with your findings and your suggestions as to how we can improve our performance, both operationally and substantively. In response to your recommendations, I have directed my management team to:

- develop and implement an integrated agency-wide strategic plan in which all activities are connected to agency goals. Where activities are not connected to an agency goal, we will consider discontinuing that activity or recommend the transfer of the activity to another, more properly suited, agency. (For example, we concur with your assessment that the Dry Cleaning Program does not fit within the agency's mission, and are sponsoring legislation to eliminate the program.)

- set appropriate goals by which we can measure the effectiveness of each of our activities. We further agree that we should set challenging benchmarks, even if the mandated program requirements are low.

- develop systems for following up with businesses in a concise and uniform way to measure the economic benefits of our activities. While we concur with the importance of these follow-up measures, we will develop and utilize them only to the extent they do not divert significant resources from our primary mission to assist business and economic development. At a minimum, where we have follow-up contact with clients, we will systematize the data-gathering and update existing reports.

Your review of legislatively mandated reports uncovered a couple of requirements we either did not know existed or thought had been repealed. We will complete the reports that are outstanding or, as appropriate, recommend to the Legislature elimination or consolidation of unnecessary or outdated mandated reports.

With regard to the specifics of your audit findings, I have attached an addendum to this letter that details our agreements and the instances on which we disagree, on a point-by-point basis.

Again, I thank you for a very productive audit and review of our programs and activities. Through these efforts, you and your staff have given us the tools by which we can build a more meaningful planning and evaluation process that in turn will make the agency that much more effective in continuing to strengthen California's economy.

Sincerely,

Julie M. Wright

JULIE MEIER WRIGHT
Secretary

COMMENTS ON DRAFT AUDIT REPORT

Chapter 1

1. Page 1-6, paragraph 2 - We agree that, while some foreign office plans are good, others did not have well-linked goals and objectives, did not establish benchmarks for some of their significant activities, and reported outcomes that were not linked to any specific goal or objective. Most of these business plan deficiencies are addressed in each of the office's FY 1995-96 business plan. Management will ensure that all business plans for FY 1996-97 will address the linkages among goals and objectives, benchmarks and results.

2. Page 1-8, paragraph 3 - While it is true that the Mexico office did not set benchmarks for the number of distributors and importers it would locate in a given year, the report did not acknowledge that the Mexico City office has one of the most extensive and detailed databases in all of Mexico for such trade information. The American Chamber of Commerce in Mexico City and the US Embassy regularly refer companies to this office for assistance in tracking down the appropriate Mexican companies for business contacts. We will strengthen the office's benchmarks.

3. Page 1-8, paragraph 4 - We concur that the Office of Export Development (OED) has not included formal, quantified goals in its annual business plans. Performance goals and benchmarks have been set on a working basis. OED's working goal has been to achieve a "substantial year-on-year increase in documented exports," with a benchmark target of 10% annual growth. Due to program innovations in 1995, OED achieved actual export growth over 1994 of approximately 20%. OED will be formally including this goal in its 1996-97 business plan. OED does not believe benchmarks on individual events are possible since many companies lack sufficient experience to make meaningful projections.

4. Page 1-9, paragraph 2 - The Office of Small Business (OSB) agrees that until the 1995-96 fiscal year, it did not set goals for its loan guarantee program in terms of the number of graduates from the program. For the 1996-97 contracts with the regional corporations, OSB intends to include specific goals for new and repeat/renewals. We plan to increase the percentage of new borrowers from 70% to 80% and reduce the repeats/renewals from 30% to 20%. By providing performance incentives in the new contract with the regional corporations, OSB will reach its goal of increasing the number of graduates and decreasing the number of repeats/renewals.

5. Page 1-10, paragraph 1 - We will strengthen the use of benchmarks in all of our plans and tie results to the benchmarks. We will conduct a semi-annual update of plans to assure they can be measured on a fiscal-year basis. We concur that the business plans in the International Trade and Investment Division were based on a fiscal year time period, but the results were reported on a calendar year basis. In order to more clearly

Note: Page numbers have changed.

link outcomes with revenue spent, this division will move from doing a calendar-based year-in-review to a fiscal year review for all of its 13 offices.

6. Pages 1-12 and 1-13 - We agree that established benchmarks need adjustment in the Small Business Development Center Program. The milestones for the small business development centers (SBDCs) will be revised and reflected in an amendment of each center's contract.

7. Page 1-15, paragraph 1 - We agree that it would be beneficial to establish outcome-based benchmarks for the tourism marketing program, as feasible and appropriate. This will be phased-in over time since generally accepted quantitative methods for measuring the overall effectiveness of state tourism marketing programs do not yet exist. The auditors acknowledged that they contacted numerous other states to determine whether any of them had the kind of outcome-based benchmarks they are recommending for California. They found none. In fact, CalTour is widely acknowledged as being among the experts and pioneers in travel and tourism accountability research. Following models established by the U.S. Travel and Tourism Administration's Accountability Task Force, we are now able to quantify the return on investment (ROI) directly attributable to the Division's advertising and literature distribution programs, which together account for 67 percent of the tourism marketing budget. It is in those cases where sophisticated ROI measures have not yet been developed, or where the research may cost more than the marketing activity itself, such as determining the volume of visitation resulting from press releases, that informal or indirect evaluation measures are used. It should be noted that conducting such research, such as nationwide pre- and post-advertising surveys, are quite costly. Should the referendum provisions of the California Tourism Marketing Act pass, we expect that expanded funding for survey research and evaluation studies would become available. 1*

   We further believe that public and private sector judgments as to the success of these programs and activities must not be discounted. This is undoubtedly why the Legislature gave final approval of the annual Tourism Marketing Plan to the California Tourism Commission, and stressed the importance of the collaborative process required by the California Tourism Policy Act. We believe these measures provide exceptionally high standards of accountability for the state's investment in tourism marketing.

8. Page 1-15, paragraph 3 - We disagree with the auditor that we ought to set goals for all of the economic benefits we capture on the loan guarantee program, namely, jobs created and sales and use tax generated by borrowers in the program. For instance, OSB and its eight regional corporations can influence the number of new businesses that participate in the program, and should strive to achieve a certain goal. Jobs created or sales or use taxes generated are results of the program's activity, not areas where a goal ought to be set and performance measured against it. Furthermore, setting such goals may inappropriately bias the types of small businesses the program 2

A-2

*The California State Auditor's comments on this response begin on page 81

would help, i.e. businesses that specifically generate sales tax versus businesses that generate new investment or well-paying jobs.

9. Page 1-16, paragraph 2 - While each foreign office will link reported outcomes with specific goals, ITI will continue to allow its offices the flexibility to develop business plans with goals and objectives tailored to the individual country dynamics where the offices are located, thereby allowing foreign office directors the ability to initiate programs which best serve the State's trade needs in diverse economies. Job creation, measured by an annual 10 percent increase in export sales and foreign direct investment, will continue to be a more important measure of ITI's success. By refining business plan development as recommended by the State Auditor, ITI will more clearly demonstrate the value of the overseas offices.

10. Page 1-19 - We agree with the auditor's findings that OSB has not independently verified the economic benefits projected by a borrower seeking a loan guarantee. We have also not required the regional corporations to independently verify the information they provide to OSB re economic benefits. We agree that OSB should verify the data provided regarding the number of jobs created or retained. We intend to follow up on the auditor's suggestion that we work with other state agencies, such as EDD, to verify job creation activity.

11. Page 1-19 - We disagree with the auditor's suggestion that Office of Export Development's results are ineffective and should be updated to measure the success of trade shows. The initial estimates of export sales are based on post-show surveys completed by each company participating in an OED-sponsored trade show. These surveys are conducted immediately after the event. The success of a trade show is based on the number of companies attending and the companies' export sales projections documented by the post-show survey. OED systematically verifies actual future sales made by the company in a telephone survey conducted six to eight months after a show. The verified export transaction is documented in a standardized case study. A specific event's success reflects a snapshot in time because the future export sales do not necessarily correspond to the trade show only, but rather a series of additional business negotiations or other factors. Agency policy separates verified export results documented by case studies from the estimated trade show successes documented by post-show surveys. If they can be fairly reconciled, the aggregate trade show successes will be updated to reflect the case studies. 3

12. Pages 1-21 and 1-22 - While we have been satisfied and successful with our budgeting decision making to date, the Agency agrees that better management information would improve this process. We can expect improvements from new accountability measures, but we maintain that the Agency's budgeting process is already flexible and dynamic. We have added resources to key programs in response to sectoral changes, such as defense conversion, military base reuse, and booming international markets. We have also discontinued or de-emphasized programs that are ineffective or unresponsive to economic development needs, such as the California

Supplier Improvement Program and the Business Environmental Assistance Centers.

The auditors have noted the lack of a strategic plan. We decided to set aside this process while we devoted Agency resources to the Economic Strategy Panel efforts because our programmatic and budgetary directions will be guided by an understanding of where the economy is going.

We also use the traditional incremental approach to agency budgeting to ensure that offices that do not have significant changes in activities continue to operate with adequate resources. Prior year expenditures must be assessed and overages and shortages accounted for, to avoid duplicating problems from year-to-year.

Chapter 2

13. Page 2-1, paragraph 2 - The auditor's comments overstate the situation. OSB has, in fact, "ensured it properly carried out its monitoring responsibilities in the loan guarantee." The Contracts, Grants and Loans unit in the agency annually audits the portfolio of each of the eight regional corporations. On a monthly basis, OSB staff review each corporation's invoice to ensure contract budgets are not overspent. We request supporting documentation for some expenses. Annually, each regional corporation obtains an independent CPA audit of all its operations, including the corporation's operation of the loan guarantee program. 4

    While it is true that OSB has not followed through on updating the general policies and procedures manual to provide guidance to the corporations for the loan guarantee program, each corporation, by law, utilizes a board of directors composed of community members to ensure the specific requirements and intent of the loan guarantee program are fully met. OSB has long been confident that each board of directors, and the loan committees affiliated with these boards, ensures the integrity of the program. The portfolio and CPA audits confirm this.

14. Pages 2-2 to 2-4 - We agree with the auditor's findings that, without guidelines from OSB, corporations may be interpreting loan guarantee program laws and regulations differently from one another and possibly inconsistent with OSB policies. At the auditor's suggestion, we have reviewed the draft policies and procedures and identified areas where revisions or clarification are needed. We will next seek input from the corporations on credit policies and guidelines in order to issue new credit policies and procedures as soon as possible. This matter must be reviewed by the Small Business Development Board, which functions under a committee structure and meets bi-monthly. We plan to have a final draft of the credit policies for the Board's consideration at its July meeting.

15. Page 2-6 - We agree that OSB did not audit fiscal years 1993-94 and 1994-95 in the manner it had in the past. OSB intends to audit the regional corporations for those fiscal years; however, depending on the cost estimate from the Department of Finance

to perform this work, we may pursue an outside audit firm under a competitive bid process. Last year, however, OSB amended the corporation's contracts for FY 1995-96 to expand the scope of the required CPA audit to assurethat disbursements comply with the terms of the contract.

With respect to the auditor's comments regarding questioned costs, it should be noted that in a case where we had concerns, OSB collected reimbursement for questioned costs amounting to $24,000 for the one corporation audited for fiscal year 1994-95.

16. Page 2-6 - We agree that OSB has not performed required program reviews of SBDCs in the specified time frame; however, OSB has "caught up" on these reviews. From April, 1995 when SBA established priority for 13 program reviews, we completed all priority reviews by December 14, 1995. As of the end of March, 1996, OSB completed another 8, for a total of 21 in an 11-month period. By the end of April 1996, we will have completed another 4. We planned to have the remaining 2 centers reviewed during April; however, one center director is out of the country until May, and the other center's administrator will not return from maternity leave until June. They will be completed this summer.

    We also now have in place an annual schedule of reviews and a process for scheduling reviews that will ensure we meet all goals.

17. Page 2-8 - While we disagree with the auditor's interpretation of the monitoring requirements imposed on OSB as the recipient of federal funds for the SBDC program, we do agree that we do not have an adequate system in place to ensure that subrecipients of that grant money comply with federal audit requirements. OSB has neither the staff to monitor nor the resources to pay for either a review of audit findings and their resolutions or the performance of a program audit of all its SBDC host organizations. It makes no sense for this office to be responsible for ensuring that a community college district, a typical subrecipient under this program, has met all of its federal audit requirements. Instead, in our contracts with these districts, we require that they comply with all federal requirements, including audit requirements. Instead of our reviewing each host organization's single audit to ensure it has met these requirements and have rectified any findings, we will obtain a certification from the responsible party, such as the Chancellor, that it has conducted the required audit and rectified any and all problems identified in the audit's findings. Failure to provide this certification may result in discontinuing our contract with that district. We intend to seek concurrence with the Office of Inspector General that this process meets federal requirements. For host organizations not subject to the single audit requirement, we will require their submitting to us the required program audit. We will monitor the center's plans for addressing any audit findings. Failure of a center to comply with this requirement may result in discontinuing our contract with that center. 5

18. Page 2-10, paragraph 3 - The Agency concurs that the information reported by the SBDCs using the automated data processing system produces inaccurate information when summary performance data are compiled by the centers. The Agency data processing unit and OSB have agreed to hire a systems consultant to determine the feasibility of re-designing the system to meet OSB's needs or to migrate the existing data to another platform. We expect to complete this project by July.

19. Pages 2-12 and 2-13 - We concur that the Sudden and Severe Program did not comply with certain loan requirements. A revised Administrative Plan has been submitted to the Economic Development Administration for approval. The revised Administrative Plan will give the program manager discretion to request "turn down" letters from banks, but will not condition loan approval on the absolute necessity of obtaining such documentation. The revision will still require the program to consider the company's ability to obtain financing elsewhere, but will allow flexibility in the event that rejection letters are difficult to obtain. A second revision to the Plan will allow the Loan Board to extend financing terms in exceptional cases.

20. Pages 2-14 and 2-15 - the Agency does not agree that future monitoring has not been addressed for the Old Growth Program. The audit report leaves the impression that, based on verbal discussions, monitoring of the Old Growth funds will cease after the Trade and Commerce Agency's grant agreement with the U.S. Forest Service expires. In fact, the verbal discussions referred to included a discussion of the Forest Service's intent to monitor reuse of the Old Growth funds by the local economic development corporations. We are currently attempting to get the Forest Service to commit to its intentions in writing. 6

21. Pages 2-16 to 2-18 - The audit found that the agency generally complied with state and federal contract and grant requirements. It identified 11 contracts as having been "backdated," where the contract is formally approved after the beginning term date of the document. As a result of the auditor's finding, the Agency has instituted a strengthened policy that contracts, grants and loans shall not be backdated within the Agency. All documents will become effective upon the approval date of the document to reflect the statutory language of the Public Contracts Code and the State Administrative Manual. Several procedural changes have also been implemented that should allow the Agency to achieve the goal of eliminating backdated contractual documents.

Chapter 3

22. Page 3-3, paragraph 2 - We disagree that "efforts are now being directed exclusively toward providing for financing needs that can be met by local governments" for two reasons. First, we still believe that issuing industrial development bonds (IDBs) is an appropriate function for the Agency. Such a function has already reduced costs in the IDB marketplace. Second, CEDFA staff are currently working on a number of other financing initiatives. These include: 7

- A tax-exempt revenue bond (not an IDB) for public television station KQED in San Francisco;
- A proposal presented by the California Energy Commission to recapitalize one of its revolving loan funds through the issuance of a revenue bond;
- A proposal by the University of California to assist with the development of new administration offices through the use of bond financing; and
- An application submitted by Caltrans to the U.S. Department of Transportation that would allow Caltrans to use CEDFA and the State Infrastructure Bank to finance certain transportation projects.

In addition, CEDFA staff has begun planning for activation of the State Infrastructure Bank should the General Obligation bond proposed by Assembly Bill 3352 be approved by the voters in November.

23. Page 3-3 - The Agency concurs that "the Dry Cleaning Plant Registration Program should be transferred or discontinued." SB 2100 (Haynes) would eliminate the dry cleaning plant registration program. The bill unanimously was passed out of the Senate Business and Professions committee on April 9, 1996 with no testimony in opposition. In fact, the dry cleaning industry representative testified in favor of the bill.

24. Page 3-5 - While the agency does not agree that its six direct loan programs are duplicating efforts with separate loan officers, we will evaluate whether there are opportunities for streamlining some functions.

Chapter 4

25. Pages 4-1 to 4-7 - The Agency agrees that it did not prepare 3 of the 20 reports required by statutes. It is still the Agency's position that the permit reform act does not apply to the Film Office and that a report was therefore not required. With regard to future reporting, the Agency will review all current statutory reporting requirements and determine if any of the current reporting requirements should be modified. In those cases, statutory revisions will be requested. Otherwise, the Agency will make a diligent effort to submit all required reports on time, addressing all required topics. 8

Chapter 5

26. Pages 5 -1 and 5-3 - We agree with the majority of the recommendations except as noted in this commentary. We have already embarked on processes to institute changes or improvements, some of which have been acknowledged in the auditor's report. We expect to be able to report on these changes in more detail in the follow up reports mandated by the audit process.

Comments

California State Auditor's Comments on the Response by the Trade and Commerce Agency

To provide clarity and perspective, we are commenting on the Trade and Commerce Agency's (agency) response to our audit report. The numbers correspond to the numbers we have placed in the response.

1 The agency's statement is incorrect. We contacted five states regarding their establishment of benchmarks for their tourism activities and determined that two states did set targets for some outcomes.

2 Both jobs created or retained and sales and use taxes generated are benefits associated with the Loan Guarantee Program and, as such, we believe they should be reflected in the program's goals and objectives. Further, if the agency feels there are other benefits that should be targeted, such as new investment and the creation of well-paying jobs, then these, too, should be reflected in the goals and objectives for this program.

3 The follow-up process we describe for the Office of Export Development was only used as an example to point out the fact that the agency rarely uses the information it obtains during its various follow-up efforts to update the aggregated estimated results it reports on and, therefore, it is ineffective.

4 We do not overstate the situation. There was a two-year gap when the expenses made by the eight corporations were not audited to determine if they were allowable according to their respective contracts.

5 Irrespective of whether the agency believes the requirement makes sense, the fact remains that federal regulations mandate that the agency, as the primary recipient of federal funds, be responsible for ensuring all audit requirements are met.

6 On page 41 of the report, we acknowledge that the agency stated that it has had verbal discussions with the U.S. Forest Service. However, we believe that verbal discussions are insufficient and that the agency should obtain a definitive statement on future monitoring responsibilities from the U.S. Forest Service.

7 We are pleased that the Financing Authority is now exploring other financing opportunities. However, during our fieldwork, the Financing Authority was focusing its efforts exclusively on projects involving industrial development bonds.

8 As we state on page 56, the Film Office issues licenses to use state property. The Permit Reform Act, which requires the report for any state agency that issues permits, defines licenses required by a state agency to engage in a particular activity as a permit. Thus, we could not conclude that a report was not required.

cc: Members of the Legislature
Office of the Lieutenant Governor
Attorney General
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps